

**REPORT OF THE  
JOINT COMMITTEE ON TAXATION  
RELATING TO THE INTERNAL REVENUE SERVICE  
AS REQUIRED BY THE  
IRS REFORM AND RESTRUCTURING ACT OF 1998**

Prepared for the

HOUSE COMMITTEES ON WAYS AND MEANS,  
APPROPRIATIONS, AND GOVERNMENT REFORM  
AND THE SENATE COMMITTEES ON  
FINANCE, APPROPRIATIONS, AND GOVERNMENTAL AFFAIRS

For a Joint Review  
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By the Staff

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JOINT COMMITTEE ON TAXATION



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## INTRODUCTION

The Internal Revenue Service Restructuring and Reform Act of 1998<sup>1</sup> (the "IRS Reform Act") made comprehensive changes relating to the operations of the Internal Revenue Service ("IRS"). Goals of the IRS Reform Act included increasing public confidence in the IRS and making the IRS an efficient, responsive, and respected agency that acts appropriately in carrying out its functions.<sup>2</sup> The IRS Reform Act included changes relating to IRS organization and management, Congressional oversight, electronic filing, and taxpayer protections and rights.<sup>3</sup>

Under provisions relating to the Congressional oversight, the IRS Reform Act requires a joint review of IRS activities.<sup>4</sup> The joint review is to include two members of the majority and one member from the minority of each of the House Committees on Ways and Means, Appropriations, and Government Affairs. The joint review is to be held at the call of the Chairman of the Joint Committee on Taxation ("Joint Committee"), and is to take place before June 1 of each calendar year 1999 through 2003.<sup>5</sup> The joint review is to address the strategic plans and budget of the IRS and such other matters as determined by the Chairman of the Joint Committee.

The IRS Reform Act also requires the Joint Committee to report annually to the Senate Committees on Finance, Appropriations, and Government Affairs, and the House Committees on Ways and Means, Appropriations, and Government Reform regarding certain matters relating to the IRS. The report is to be made in each calendar year 1999 through 2003.<sup>6</sup>

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<sup>1</sup> Pub. L. No. 105-206 (July 22, 1998).

<sup>2</sup> H.R. Rep. No. 105-364, Pt. 1, at 34-35 (1997) and S. Rep. No. 105-174, at 11-12 (1998).

<sup>3</sup> For a summary of the IRS Reform Act's taxpayer rights and protections, see *Summary of Revenue Provisions Contained in Legislation Enacted During the 105th Congress* (JCX-75-98), November 19, 1998, at 61-77. See also, Internal Revenue Service, Highlights of 1998 Tax Changes, Publication 553 (December 1998), at 20-25.

<sup>4</sup> Internal Revenue Code ("Code") sec. 8021(f)(2).

<sup>5</sup> The first joint review was held on May 25, 1999. A transcript of the first joint review is published in Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 1999*, May 25, 1999 (JCS-4-99). The second joint review was held on May 3, 2000. A transcript of the second joint review is published in Joint Committee on Taxation, *Strategic Plans and Budget of the Internal Revenue Service, 2000*, May 3, 2000 (JCS-4-00).

<sup>6</sup> Sec. 8022(3)(c). The previous two reports can be found at *Report of the Joint Committee on Taxation Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998* (JCX-24-99), May 20, 1999 and *Report of the Joint Committee on Taxation Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998* (JCX-46-00), April 28, 2000.

Pursuant to the IRS Reform Act, a joint review of the strategic plans and budget of the IRS for fiscal year 2001 has been scheduled for May 8, 2001. This document,<sup>7</sup> prepared by the staff of the Joint Committee, contains the report of the Joint Committee relating to the IRS as required by the IRS Reform Act.

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<sup>7</sup> This document may be cited as follows: Joint Committee on Taxation, *Report of the Joint Committee on Taxation Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998* (JCX-33-01), May 4, 2001.

## EXECUTIVE SUMMARY

### A. IRS Mission Statement and Overview of IRS Strategic Plans

#### **Mission statement and statement of strategic goals**

As required by the IRS Reform Act, the IRS has restated its mission statement to focus on interaction with taxpayers. The new IRS mission statement is to:

Provide America's taxpayers with top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

To assist in achieving its mission, the IRS has developed three strategic goals:

- (1) To provide top quality service to each taxpayer;
- (2) To provide top quality service to all taxpayers; and
- (3) To increase productivity within the IRS by providing IRS employees with a quality work environment.

The IRS describes the process of change necessary to meet its goals and fulfill its mission statement as "modernization."

#### **Providing top quality service to each taxpayer**

The IRS has made some progress toward achieving the goal of providing top quality service to each taxpayer, but challenges in reaching this goal remain. This goal can be measured by taxpayers' view of the performance of the IRS. Since the passage of the IRS Reform Act in 1998, the IRS public opinion rating has improved. Nonetheless, the IRS rating remains well below that of other agencies. The IRS Oversight Board believes that the IRS is not meeting this goal. For example, the IRS Oversight Board has reported that 35 percent of calls made to the IRS for assistance are not answered, customer service representatives have inadequate training and access to information, walk-in hours are limited, and IRS notices continue to be unclear and difficult to understand. The Treasury Inspector General for Tax Administration ("TIGTA") has similarly testified that in 368 random test calls, TIGTA personnel were unable to reach the IRS 37 percent of the time and, when access was obtained, the IRS incorrectly responded to 47 percent of the questions. Tax practitioner groups have indicated that IRS personnel have been more professional and responsive and that the new operating divisions have been reaching out to taxpayers and practitioners. However, such groups, the National Taxpayer Advocate, and others have raised concerns about the time it takes to resolve certain cases.

## **Providing top quality service to all taxpayers**

The goal of providing top quality service to all taxpayers is intended to ensure that the tax laws are applied fairly and that taxpayers who fail to comply do not burden those who do comply. Enforcement and compliance are essential components of this goal.

Since the passage of the IRS Reform Act, traditional enforcement activities have declined. In fiscal year 2000, the audit rate dropped to less than one-half of one percent. The IRS Oversight Board has noted that the decline in enforcement activities raises questions about tax compliance and fairness to the vast majority of citizens who pay all their taxes. The IRS has similarly noted that compliance by taxpayers with only wage and investment income is beginning to decline among the taxpayers with who have wage and investment income as a result of a lack of a balanced and effective compliance program. The IRS generally attributes the drop in enforcement to a decline in staffing and the shifting of personnel toward customer service.

The Commissioner has stated that it is unnecessary to return to the level of enforcement that existed even five years ago, which was three times that in fiscal year 2000. The IRS has an aggressive document matching program to detect underreported income, and will take steps to stabilize the level of traditional compliance activities. The IRS also hopes to target enforcement and compliance efforts more effectively, and to reduce the need for some enforcement efforts by focusing on prefilling efforts, thereby increasing voluntary compliance. There is currently no reliable measure of compliance. However, from available information, the IRS has determined that compliance is uneven and that there are major problem areas of noncompliance, including the proliferation of corporate tax shelters and the earned income credit.

## **Productivity through a quality work environment**

As its third strategic goal, the IRS plans to increase productivity by providing a quality work environment for employees. The IRS notes that success in this goal requires providing employees with high quality technology tools, adequate training, effective management, and active engagement in the goals of the organization.

Although overall job satisfaction increased somewhat in 2000 (60 percent compared to 54.5 percent in 1999), the IRS Oversight Board has found that IRS employee morale and job satisfaction are not adequate. Employee satisfaction differs significantly between different racial, national origin, and gender groups. Causes of employee dissatisfaction include inadequate training, lack of confidence in IRS reforms, and inadequate systems technology.

### **B. Implementation of IRS Strategic Goals**

#### **Guiding principles and major strategies**

To carry out its strategic goals, the IRS has developed six guidance principles and 10 major strategies. These strategies are to:

- Meet the needs of taxpayers;
- Reduce taxpayer burden;

- Broaden the use of electronic interactions;
- Address key areas of noncompliance;
- Stabilize traditional compliance activities;
- Build a capability to deal effectively with the global economy;
- Meet the special needs of the tax-exempt community;
- Recruit, develop, and retain a qualified workforce;
- Provide high quality, efficient, and responsive information services and shared support services; and
- Promote effective asset and information stewardship by improving internal processes for information management, financial management, and asset management.

### **Organization modernization**

The IRS has reorganized its structure to establish four operating divisions designed to serve taxpayers with similar needs. This structure is intended to enable the IRS to meet all a taxpayer's needs in one place. The new organizational structure formally replaced the prior geographically-based structure on October 1, 2000. Top management is in place for each of the operating units; final stages of implementation, including redistribution of workloads, is expected to take place through fiscal year 2002.

The four operating divisions are:

- (1) Wage and Investment, which serves approximately 116 million taxpayers who have income from wages and investments only;
- (2) Small Business and Self-Employed, which serves 45 million taxpayers, including taxpayers with only self-employment income, self-employment income and other income (e.g., wage income), and small businesses.
- (3) Large and Mid-Size Business, which serves 210,000 taxpayers, including C corporations, S corporations, and partnerships with assets greater than \$5 million.
- (4) Tax-Exempt and Government Entities, which serves three million entities, including pension funds, charitable organizations, State and local governments. This division also encompasses issues relating to tax-exempt bonds.

In addition to these operating divisions, the IRS also has several functional units, including Appeals, the Taxpayer Advocate Service, Crimination Investigation, and Communication and Liaison.

Although the new structure has generally been well received, issues remain as to staffing levels, consistent treatment of taxpayers both among and within the operation divisions, and adjusting to the use of services shared by the operating divisions.

## **Development of organizational performance measures**

The IRS Reform Act sought to change the IRS's historical focus of enforcement revenue as a key measure of success. Accordingly, the IRS has developed a balanced measures system that included business results (both quality and quantity), customer satisfaction, and employee satisfaction.

The General Accounting Office has reported that the IRS has made progress in implementing its new performance measures, but also faces some challenges. For example, the General Accounting Office reported that the performance management system is most fully developed at the organization-wide level, and is weakest at the front-line level.

## **Technology modernization**

The deficiencies in IRS systems have been the subject of substantial publicity, and the IRS has been working on systems modernization for over a decade. The path to modernization has not been trouble free. In May 2000, the General Accounting Office reported that the IRS was just as challenged then as it was when the IRS Reform Act was enacted.

Despite the challenges facing the IRS, the General Accounting Office has found that the IRS has begun to lay a foundation, which should facilitate changes to IRS business practices; however, substantial challenges remain in the areas of performance management and information systems modernization. The General Accounting Office has noted that the IRS has developed a massive modernization effort, which will likely take more than a decade to complete.

The IRS's taxpayer database is stored in its master file, which is updated weekly. The IRS plans to replace the master file with the customer account data engine. The customer account data engine is expected to provide a modern system for storing taxpayer data, which would allow the IRS and taxpayers to have up-to-date access to taxpayer information and records.

### **C. IRS Budget Request for Fiscal Year 2002**

#### **Administration's fiscal year 2002 budget request**

For fiscal year 2002, the Administration's IRS budget request totals \$9.276 billion and 99,116 full-time equivalent positions, not including funding and staffing for the earned income credit program. The fiscal year 2002 budget request reflects a \$580 million increase from the fiscal year 2001 appropriated level of \$8.696 billion and an increase of 1,843 full-time equivalent employees from the fiscal year 2001 proposed operating level of 97,273 full-time equivalent employees.

In addition, the Administration's IRS budget request includes \$146 million and 2,236 full-time equivalent employees for the earned income credit compliance initiative, which reflects a \$1.319 million increase from the proposed operating level for fiscal year 2001, due to adjustments necessary to maintain current levels. The fiscal year 2002 budgeted staffing levels would remain unchanged from the proposed operating level for fiscal year 2001. The earned

income credit program is funded outside the discretionary spending caps. Fiscal year 2002 is the fifth year of funding for this five-year compliance initiative. The compliance initiative provides for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce overclaims and erroneous filings associated with the earned income credit.

The IRS's overall budget request for fiscal year 2002, including funding and staffing for the earned income credit, totals \$9.422 billion and 101,352 full-time equivalent employees.

### **IRS Oversight Board's fiscal year 2002 IRS budget recommendation**

The IRS Oversight Board has stated that the Administration's fiscal year 2002 budget request "does not adequately support the IRS Strategic Plan and provides inadequate support for technology modernization." The IRS Oversight Board finds that the IRS operations budget should be increased by approximately six percent from fiscal year 2001 levels to account for inflation, mandatory cost increases, normal salary increases and promotions.

For fiscal year 2002, the IRS Oversight Board has recommended a total budget of \$10.260 billion, which includes \$8.992 billion for operations and \$1.268 billion for IRS modernization, which is a total of \$838 million more than is requested by the Administration. The IRS Oversight Board made its fiscal year 2002 budget recommendation in terms of the IRS's strategic goals and objectives, noting that the operations budget is directly linked to the strategic goals of the IRS. In its fiscal year 2002 budget recommendation, the IRS Oversight Board has allocated 40 percent to "Top Quality Service to All Taxpayers," or \$3.597 billion; 36 percent to "Productivity Through a Quality Work Environment," or \$3.237 billion; and 24 percent to "Top Quality Service to Each Taxpayer," or \$2.156 billion. The IRS Oversight Board's recommendation would represent approximately a 13 percent increase over fiscal year 2001 levels resources and funding for activities that provide service to each taxpayer. The IRS Oversight Board made this recommendation because it believes that resources should go where taxpayers need help.

### **Financial Audit of IRS Fiscal Year 2000 Financial Statements**

For the first time since the General Accounting Office began annual audits of IRS financial statements, it expressed an unqualified opinion on all IRS financial statements for fiscal year 2000. The ability to issue an unqualified opinion is attributed to the combined efforts of the IRS and the General Accounting Office. The General Accounting Office continues to identify weaknesses in IRS internal controls.

#### **D. Other Matters Addressed by the IRS Reform Act**

### **IRS Oversight Board**

The IRS Oversight Board created by the IRS Reform Act began operations in September 2000. Since then, the Board has been meeting for two days every two months. Much of the Board's initial activities have been learning about IRS operations and identifying problem areas. In its interim report, the IRS Oversight Board identified the following significant problems:

inadequate taxpayer service; the level of enforcement activities; outdated computer systems; and poor employee morale and job satisfaction.

The IRS Oversight Board has reviewed and approved the IRS strategic plan. The Board strongly supports the mission and goals defined in the plan and believes that the framework described in the plan is logical and represents the best way forward. However, the Board recognizes that meeting the goals of the plan will be difficult, will take time, and will require the continuous support of the Administration and the Congress.

As described above, the IRS budget approved by the IRS Oversight Board differs in significant respects from that submitted to Congress by the Administration. The Board believes that the Administration budget does not adequately support the IRS strategic plan or IRS technology needs.

### **National Taxpayer Advocate**

The National Taxpayer Advocate (through the Office of the Taxpayer Advocate) has four principal functions: (1) to assist taxpayers in resolving problems with the IRS; (2) to identify areas in which taxpayers have problems in dealing with the IRS; (3) to propose changes in the administrative practices of the IRS to mitigate such problems; and (4) to identify potential legislative changes which may be appropriate to mitigate such problems. According to the National Taxpayer Advocate's most recent annual report, the reorganized Office of the Taxpayer Advocate has turned its attention away from modernizing its organizational structure and toward conducting its day-to-day business as the newly modernized and independent Taxpayer Advocate Service. The National Taxpayer Advocate successfully reassigned its casework from employees working in IRS Operations to its newly hired and trained staff.

The National Taxpayer Advocate report identified the following areas as some of the most serious problems identified by individual and business taxpayers, tax practitioners, and IRS employees: (1) complexity of the tax law (individuals and businesses); (2) clarity and tone of IRS communications; (3) inability to access the IRS toll-free number; (4) burden on small business; (5) administration of the earned income credit; (6) lack of one-stop service; (7) lack of acknowledgement of correspondence and payments; (8) penalty administration; (9) offer-in-compromise issues; and (10) misapplied payments.

The National Taxpayer Advocate report stated that the most litigated tax issues are: (1) penalties and interest; (2) court procedures; (3) the deductibility of business expenditures; (4) filing status; (5) earned income credit; (6) dependency exemptions; (7) the definition of gross income (inclusions and exclusions); (8) accounting methods, record keeping, and documentation; (9) statute of limitations; (10) court authority for credits, refunds, and abatement; (11) self-employment issues and independent contractor versus employee status; (12) and last known address and notice of deficiency issues.

The National Taxpayer Advocate reported that during fiscal year 2000, the Taxpayer Advocate Service independently reviewed and took action to resolve over 256,000 cases. The National Taxpayer Advocate report listed the top ten sources of Taxpayer Advocate Service casework as: (1) refund issues; (2) processing of claims and amended returns; (3) processing of

original returns; (4) audit reconsiderations; (5) abatement of penalties; (6) revenue protection; (7) payment and credit problems; (8) examination of tax returns prior to assessment; (9) collection notices; (10) and lost or stolen refunds.

### **Taxpayer rights**

The provisions of the IRS Reform Act relating to taxpayer rights continue to have a significant impact on the operation of the IRS, and the IRS views its immediate challenges as training and management. Several areas illustrate the difficulties encountered by the IRS in implementing the IRS Reform Act, including collection due process, innocent spouse relief, offers in compromise, and other collection issues.

The IRS stated that the provisions relating to collection due process have created additional staffing needs because the IRS can only initiate a lien or levy action after individually reviewing the facts and circumstances of each case. The also IRS stated that the due process provisions have slowed and lengthened the overall compliance cycle. According to the IRS, the principal difficulty in carrying out the collection due process provisions of the IRS Reform Act has been engineering an efficient collection due process system that does not disproportionately expend resources on cases in which taxpayers are abusing the process to delay collection. In an effort to more efficiently process collection due process cases, the IRS assembled a team to implement collection due process recommendations made by an executive level task force. Furthermore, the IRS stated that it now has additional personnel to handle collection due process cases and is increasing the number of trained employees in fiscal year 2001. In its most recent semiannual report, the Treasury Inspector General for Tax Administration stated that the IRS has improved its compliance with many of the provisions of the IRS Reform Act relating to collection due process. However, the Treasury Inspector General also noted that the IRS has not yet fully complied with IRS Reform Act provisions requiring the IRS to provide proper and timely notice that a Federal tax lien has been filed.

Since passage of the IRS Reform Act, the IRS has faced several difficulties in implementing the innocent spouse provisions, resulting in a significant backlog of cases. In addition, some taxpayers and their representatives have apparently experienced difficulty in ensuring adequate consideration by the IRS of all of the facts relating to individual claims, particularly when the claim involves a low-income taxpayer who is not represented by counsel and the IRS solely relies upon correspondence to process the claim. The IRS stated that it has taken several measures to effectively manage the rapidly increasing volume of pending claims for innocent spouse relief.

With regard to offers in compromise, several factors have contributed to delays in processing offers. The IRS stated that it is reviewing and reengineering its work processes to address the growing number of offer in compromise cases, including centralization of cases that may be most effectively processed in a service center environment. Although the IRS Reform Act expanded the offer in compromise program to cases in which settlement would promote effective tax administration, the IRS stated that fewer than 1 percent of total offers in compromise for fiscal year 2000 through February 2001 were initiated on the basis of the additional factors specified in the IRS Reform Act, including situations involving severe or unusual economic hardship. However, tax practitioner comments indicate that, while there has

been a noticeable increase in the use of offers in compromise by taxpayers, there has not been a corresponding increase in IRS acceptance of offers in compromise. In many cases, IRS personnel still may be reviewing offers in compromise without considering the additional factors mandated by the IRS Reform Act (e.g., equity, hardship, and public policy).

In comparison with fiscal year 2000 results, the IRS stated that it is experiencing both positive and negative trends in collection activity during fiscal year 2001. The IRS noted that enforcement actions are increasing in fiscal year 2001, with positive trends in the number of liens filed and levies issued by the IRS. According to the IRS, both delinquent notice yield and Taxpayer Delinquent Account dollars collected have increased through February 2001. However, certain other collection measurements have slightly decreased in fiscal year 2001 due to the need to redirect resources to handle the increase in the numbers of offers in compromise and collection due process cases. The IRS stated that the amount of time between the filing of a return and the first compliance contact has remained constant over the years, and that the amount of time to assign cases for collection is expected to decline in fiscal year 2001. The IRS has attributed the overall decline in collection and compliance efforts in recent years to a decrease in staffing levels, the diversion of resources to customer service, an increase in employee training, and an increase in the amount of time needed to resolve cases. The IRS stated that it is taking several measures to increase the resources applied to collection and compliance activities.

### **Treasury Inspector General for Tax Administration**

The Treasury Inspector General for Tax Administration reports that although the IRS has made significant progress in complying with the IRS Reform Act and modernization, weaknesses continue to exist in certain critical areas, including restricting the use of enforcement statistics to evaluate IRS employees, providing timely notice that a federal tax lien has been filed, certifying the security of computer systems, providing computer virus protection, preventing filing fraud with respect to the earned income credit, ensuring taxpayer compliance, and protecting taxpayer rights in certain areas, including providing timely and accurate innocent spouse relief. The Treasury Inspector General for Tax Administration also reports on the number of investigations initiated and complaints about IRS personnel received, and lists past unimplemented corrective actions that it has recommended.

### **Personnel flexibility and IRS Management**

From the passage of the IRS Reform Act in July 1998 through March 20, 2001, the IRS has hired 26 Streamlined Critical Pay executives. Through March 20, 2001, eight have left. Some has stayed as few as five months and others as long as 29 months. On March 25, 2001 the IRS converted the first employees into the Senior Manager Payband established under the IRS Reform Act's workforce classification and pay authority. The IRS is developing a strategy to place most other non-bargaining unit positions in paybands.

The IRS Reform Act defined 10 specific acts of misconduct for which an IRS employee must be terminated (section 1203 of the IRS Reform Act). As of March 31, 2001, there were 243 substantiated violations of section 1203. Of the 243 substantiated violations, 213 were for failure to file a Federal tax return. Seven employees have been removed for willful failure to

timely file a Federal tax return when the employee was due a refund because he or she had overpaid the tax due.

### **E. The 2001 Filing Season**

Commissioner Rossotti has referred to the 2001 filing season as having been “smooth and almost error free.” The IRS has projected that net collections for fiscal year 2001 will exceed the \$1.9 trillion collected for fiscal year 2000. For fiscal year 2001, the IRS also projects that it will receive 215.4 million returns, including over 130.3 million individual returns, and it expects to issue over 96.8 million individual refunds. As of March 9, 2001, the IRS reported that the average dollar amount per refund was up over five percent from last year, and the average refund as of that date was \$1,823. The IRS recently announced that 34.2 million tax returns were filed electronically as of April 6, 2001.

The General Accounting Office has made four specific observations regarding the 2001 filing season. First, the General Accounting Office noted that the IRS’s reorganization had little effect on the 2001 filing season, although some improvements to customer service are still needed. Second, the General Accounting Office reported that the IRS processed returns and refunds without any significant problems and has received a larger percentage of returns electronically, but the growth rate of electronic filing is slower than expected, and many taxpayers encountered trouble using their personal identification number (instead of signatures filed on paper). Third, according to the General Accounting Office, the IRS has done a better job answering telephone calls, although there remain concerns about the declines in the productivity of telephone assistants. Finally, the General Accounting Office finds continuing concerns regarding the quality of tax law assistance being provided by IRS walk-in sites, despite the increased staffing of the IRS field assistance program.

## **I. IRS MISSION STATEMENT AND OVERVIEW OF IRS STRATEGIC PLANS**

### **A. Mission Statement and Statement of Strategic Goals**

In the IRS Reform Act, the Congress directed the IRS to review and restate its mission to increase its emphasis on serving the public and meeting taxpayer needs.<sup>8</sup> Prior to its revision, the IRS mission statement focused on collecting the proper amount of tax.

The new mission statement has interaction with taxpayers as its focus. It states:

Provide America's taxpayers with top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

To assist in achieving its new mission, the IRS has developed three strategic goals.<sup>9</sup> The first goal is to provide top quality service to each taxpayer. The second goal is to provide top quality service to all taxpayers. The third strategic goal is to increase productivity within the IRS by providing IRS employees with a quality work environment. The IRS describes the process of change necessary to meet its strategic goals and fulfill its mission statement as "modernization."

### **B. Providing Top Quality Service to Each Taxpayer**

The first strategic goal, providing top quality service to each taxpayer, is designed to ensure that every taxpayer receives first-quality service when dealing with the IRS. To achieve this goal, the IRS has determined that it needs to: (1) provide clear tax law guidance, forms, and instructions; (2) provide taxpayers with the accurate, quick, and convenient information about their tax accounts and assistance in determining how much to pay, how to pay, and how to make adjustments to their accounts; and (3) treat taxpayers professionally, with full consideration of their rights, and promptly inform the taxpayer when the agency believes additional taxes are owed.<sup>10</sup>

The IRS has not developed specific measures for achieving this goal. Ultimately, success in achieving top quality service will be measured by whether taxpayers believe the IRS is meeting their expectations. Preliminary indications are that the IRS has made progress toward meeting those expectations, but that challenges remain.

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<sup>8</sup> IRS Reform Act sec. 1002.

<sup>9</sup> The most recent strategic plans and major strategies of the IRS are contained in *IRS Strategic Plan (Fiscal Years 2000-2005)*. Internal Revenue Service, *IRS Strategic Plan (Fiscal Years 2000-2005)*, Publication 3744 (February 2001) (hereinafter referred to as "IRS Strategic Plan"). These strategic plans and major strategies are discussed below in Part II.

<sup>10</sup> IRS Strategic Plan at 4, 25.

Roper opinion research organization surveys show that, after reaching an all time low point in 1998, the agency's public approval rating has improved in 1999 and 2000. Nonetheless, the IRS rating remains well below that of other agencies.<sup>11</sup>

Since 1998, the IRS has been surveying taxpayers who have had direct contact with the IRS, either in person, over the phone, or through correspondence. According to the IRS, these surveys show that the IRS has made a modest improvement in customer satisfaction.<sup>12</sup>

The IRS Oversight Board reports that the IRS is not meeting the goal of top quality service to each taxpayer. It reports that 35 percent of calls made to the IRS for assistance are not answered and that customer service representatives have inadequate training and access to information necessary to handle complex questions.<sup>13</sup> The Treasury Inspector General for Tax Administration ("TIGTA") recently testified to similar effect. In a four-day test of the IRS' toll-free number, TIGTA personnel made 368 random test calls and were unable to gain access 37 percent of the time.<sup>14</sup> When access was successful, the IRS incorrectly responded to 47 percent of the questions.<sup>15</sup> TIGTA personnel also visited 47 Taxpayer Assistance Centers (formerly known as "walk-in sites") in 11 states. In the resulting 90 contacts, IRS personnel generally responded with courteous treatment but provided incorrect answers 49 percent of the time.<sup>16</sup>

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<sup>11</sup> The Roper survey results are reported in the IRS Strategic Plan at 26. Also included in the IRS Strategic Plan are the results from a survey conducted by the University of Michigan, known as the American Customer Satisfaction Index. The survey polls people who have dealt recently with various public and private sector organizations. The IRS has ranked last for a number of years. The electronic filing program, which was added to the survey as a separate segment in 1999, received a higher ranking than the IRS generally. *See* IRS Strategic Plan at 26-27.

<sup>12</sup> IRS Strategic Plan at 26-27. According to the IRS, the program areas with the highest ratings were in taxpayer assistance functions, such as telephone service on its toll-free lines and walk-in service. In an effort to measure its service, the IRS is also improving its systems to track complaints. Reliable numbers, however, are not yet available.

<sup>13</sup> Internal Revenue Service Oversight Board, *the IRS Budget Fiscal Year 2002: Analysis and Recommendations* (Interim Report, Spring 2001) (hereinafter "IRS Oversight Board Report") at 8.

<sup>14</sup> Statement of the Honorable David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, before the House Ways and Means Subcommittee on Oversight (April 3, 2001).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

The IRS Oversight Board further notes that walk-in hours are limited. Further, the IRS Oversight Board noted that IRS notices continue to be unclear and difficult to understand.<sup>17</sup>

In preparing this report, the staff of the Joint Committee on Taxation (“Joint Committee staff”) sought input from various groups having interaction with the IRS.<sup>18</sup> The National Association of Enrolled Agents responded that, generally, their members have experienced a more professional and responsive IRS when interacting with the agency.<sup>19</sup> The American Institute of Certified Public Accountants noted that certain IRS operating divisions have reached out extensively to taxpayers and practitioners.<sup>20</sup> However, concerns also were raised about the length of time it takes to resolve innocent spouse cases, to complete an offer in compromise, and to convene a collection due process hearing.<sup>21</sup> The National Taxpayer Advocate and others have noted that the diversion of operating division personnel to perform filing season duties delays the resolution of cases assigned to those employees who have been temporarily transferred.<sup>22</sup>

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<sup>17</sup> IRS Oversight Board Report at 8.

<sup>18</sup> The Joint Committee staff sent letters to the American Bar Association’s Section of Taxation, the National Association of Enrolled Agents, the American Institute of Certified Public Accountants, the Tax Executives Institute, the National Federation of Independent Business, the Tax Division of the United States Department of Justice, the United States Tax Court, and the IRS Oversight Board. The letters of those organizations that responded are included as appendices to this report.

<sup>19</sup> “For the most part, employees are going the extra mile to assist practitioners, even with the difficulty of reorganization. There is a more professional demeanor to interaction with the public and with the practitioner community.” Letter from Claudia Hill, Chair, Government Relations Committee, National Association of Enrolled Agents, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (April 5, 2001) (hereinafter “NAEA Letter”). In addition, the Tax Section of the American Bar Association stated, “We [] have found the leadership of [the new operating divisions] to be very open and responsive, which makes it easier for the Tax Section to communicate with these new divisions at a leadership level.” Letter from Richard M. Lipton, Chair, Section of Taxation, American Bar Association to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (April 24, 2001) (hereinafter “ABA Letter”).

<sup>20</sup> “. . . [W]e call your attention to the fact that both the [Large and Mid-Size Business and Small Business and Self-Employed divisions] have conducted extensive outreach to outside stakeholders, practitioners and taxpayers alike.” Letter from Pamela J. Pecarich, Chair, Tax Executive Committee, American Institute of Certified Public Accountants, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (April 10, 2001) (hereinafter “AICPA Letter”).

<sup>21</sup> ABA Letter and NAEA Letter.

<sup>22</sup> See e.g. Internal Revenue Service, Statement of Nina E. Olsen, National Taxpayer Advocate before the House of Representatives Committee on Ways and Means, Subcommittee on Oversight (April 3, 2001) and Statement of Claudia Hill, Enrolled Agent, National

### C. Providing Top Quality Service to All Taxpayers

The second strategic goal requires the IRS to provide top quality service to all taxpayers. This goal aims for fundamental fairness and uniform application of the law to all taxpayers. The IRS goal is to ensure that the tax law is applied with fairness and integrity so that taxpayers who fail to comply with the tax laws do not burden those who comply.

Enforcement is an essential component to achieving fair and uniform application of the law. Since the passage of the IRS Reform Act, the IRS has undertaken substantially fewer enforcement activities.<sup>23</sup> The number of audits and collection activity has declined. In fiscal year 2000, the audit rate has dropped to less than one-half of one percent and the number of individual returns audited was approximately 618,000. Declines in enforcement have resulted in the IRS collecting less enforcement revenue, \$37 billion in 1997 versus \$33 billion in 1999.<sup>24</sup> The Department of Justice has noted a significant decline in IRS referrals of both civil and criminal cases as well, which the Department attributes in large measure to the “curtailment of IRS compliance actions.”<sup>25</sup> The IRS Oversight Board noted that the decline in enforcement activities has “rais[ed] questions about tax compliance and fairness to the vast majority of citizens who pay all their taxes.”<sup>26</sup>

The IRS notes that there are indications that compliance is beginning to decline among the taxpayers who have only wage and investment income as a result of “a lack of a balanced and effective compliance program.”<sup>27</sup> It further noted that examination coverage is declining while the number of non-filer and delinquent accounts are increasing and the aging and quality of cases

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Association of Enrolled Agents, before the House of Representatives Committee on Ways and Means, Subcommittee on Oversight (April 3, 2001).

<sup>23</sup> Letter from Charles O. Rossotti, Commissioner, Internal Revenue Service, to Charles E. Grassley, Chairman, Senate Finance Committee (March 26, 2001). The IRS attributes this decline to a continued decline in staffing, the need to assign compliance staff to customer service duties during the filing season, and a substantial increase in the amount of time required per case due to provisions of the IRS Reform Act.

<sup>24</sup> IRS Strategic Plan at 31.

<sup>25</sup> Letter from Sheryl L. Walter, Acting Assistant Attorney General, Tax Division, Department of Justice, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (April 13, 2001) (“IRS compliance actions generate civil litigation handled by the Tax Division and develop leads to possible criminal violations. Thus, the decline in our civil and criminal case numbers is doubtless caused in large measure by the acknowledged curtailment of IRS compliance actions.”).

<sup>26</sup> IRS Oversight Board Report at 8.

<sup>27</sup> IRS Strategic Plan at 98.

remains unchanged.<sup>28</sup> The Commissioner has stated, however, that there is “no need to return to the levels of individual audit coverage that existed even five years ago, which was three times the [fiscal year] 2000 level.”<sup>29</sup> The Commissioner noted that the IRS has an “aggressive document matching program to detect underreported income.”<sup>30</sup> Further, the Commissioner asserts that IRS will take the approach in the short run to “stabilize [the IRS’s] level of traditional compliance activities, such as individual audits, at or slightly above current levels and to focus them on areas where they are most required.”<sup>31</sup> The IRS also hopes to target enforcement and compliance efforts more effectively, and to reduce the need for some enforcement efforts by focusing on pre-filing efforts, thereby increasing voluntary compliance.

The IRS has no reliable measure of general compliance. The last major study of compliance was done in 1988.<sup>32</sup> This lack of a reliable measure of compliance affects the

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<sup>28</sup> IRS Strategic Plan at 97.

<sup>29</sup> Letter from Charles O. Rossotti, Commissioner of Internal Revenue, to Charles E. Grassley, Chairman, Senate Finance Committee (March 26, 2001).

<sup>30</sup> The IRS has “an aggressive document-matching program in place to cross-check wages, interest, and investment income to make sure people pay the right amount.” Internal Revenue Service, *Statement by IRS Commissioner Charles O. Rossotti on Audit and Collection Activity for Fiscal 2000* (February 15, 2001). However, Transactional Records Access Clearinghouse found the following declines based on its review of IRS data:

- (1) One key computerized agency program identifies individual returns with potential underreporting discrepancies. In the early 1990’s, the IRS followed up on one out of two or three of these possible problems. In 1998, it followed up on only one out of six.
- (2) IRS’s computer based document matching program send out correction notices to individual taxpayers. In 1991, when this particular effort peaked, the number of correction notices sent by the IRS’s computer-based document-matching program to individual taxpayers peaked, 4.8 million taxpayers were sent correction notices. In 2000, that number declined to 1.4 million.

Transactional Records Access Clearinghouse, *New Findings on Tax Collection and IRS Criminal Enforcement*, <<http://trac.syr.edu/tracirs/findings/aboutIRS/keyFindings.html>> (visited April 28, 2001). The Transactional Records Access Clearing House is a data gathering, data research, and data distribution organization associated with Syracuse University. Its analysis of the IRS Computer Document Matching Program is based on IRS data submitted to the Senate Finance Committee on March 26, 2001.

<sup>31</sup> Letter from Charles O. Rossotti, Commissioner of Internal Revenue, to Charles E. Grassley, Chairman, Senate Finance Committee (March 26, 2001).

<sup>32</sup> IRS Strategic Plan at 29.

efficient distribution of resources. In addition, the IRS does not know if general compliance is remaining steady or declining.<sup>33</sup>

The IRS's measure of success in achieving fair and uniform application of the law is based in part upon the IRS's ability to measure the uniformity of compliance among various groups of taxpayers.<sup>34</sup> The IRS has been able to determine from the available information that "compliance is quite uneven and that there are major problem areas in which significant noncompliance still exists."<sup>35</sup> Among the areas of noncompliance identified by the IRS are the proliferation of corporate tax shelters and noncompliance with the requirements of the earned income credit.<sup>36</sup>

#### **D. Productivity Through a Quality Work Environment**

As its third strategic goal, the IRS plans to increase productivity by providing a quality work environment for its employees. Comparing its goals to organizations within the private sector, the IRS notes that success with this goal requires providing employees with high-quality technology tools, adequate training, effective management, and active engagement in the goals of the organization. The IRS is working to create a positive work place where there exist equal opportunity, recognition of employee performance, and no artificial barriers to advancement. The IRS measures success in building productivity by increasing its workforce only slightly while concurrently handling an increased workload, and improving performance on the other two quality service goals discussed above. Employee satisfaction is also measured as part of this goal.

According to the IRS, overall job satisfaction for IRS employees was 54.5 percent in 1999.<sup>37</sup> This figure increased to 60 percent in the year 2000.<sup>38</sup>

According to the IRS Oversight Board, IRS employee morale and job satisfaction are not adequate.<sup>39</sup> The IRS strategic plan notes the employee satisfaction differs significantly between race, national origin, and gender groups.<sup>40</sup> Further, according to the IRS Oversight Board,

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<sup>33</sup> *Id.* at 5.

<sup>34</sup> *Id.* at 5.

<sup>35</sup> *Id.*

<sup>36</sup> IRS strategies for addressing these areas of noncompliance are discussed below.

<sup>37</sup> IRS Strategic Plan at 33.

<sup>38</sup> *Id.*

<sup>39</sup> IRS Oversight Board Report at 9.

<sup>40</sup> IRS Strategic Plan at 98.

employees lack confidence that the reforms being made will continue or have any real impact.<sup>41</sup> According to the IRS Oversight Board, many employees believe that they are performing tasks that are inconsistent with their experience and skill level.<sup>42</sup> The IRS strategic plan notes that employees and managers do not have the skills to deliver top quality service.<sup>43</sup> The IRS Oversight Board reports that employees believe that the training they are receiving is inadequate and inappropriate.<sup>44</sup>

According the IRS Oversight Board, the IRS is also not providing a quality work environment. The ability of IRS personnel to respond to taxpayer questions and efficiently perform critical duties is limited by the fact that the IRS computer systems are outdated and incompatible with each other.<sup>45</sup> Not enough data is captured from tax returns, and the databases are not up-to-date.<sup>46</sup> A discussion of the IRS's efforts to improve its technological infrastructure is discussed at Section II. D. of this report, below.

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<sup>41</sup> The IRS Strategic Plan similarly notes that employees are becoming less confident in IRS management. IRS Strategic Plan at 98.

<sup>42</sup> IRS Oversight Board Report at 9.

<sup>43</sup> IRS Strategic Plan at 98.

<sup>44</sup> IRS Oversight Board Report at 9.

<sup>45</sup> *Id.* at 8-9.

<sup>46</sup> *Id.* at 8-9.

## II. IMPLEMENTATION OF IRS STRATEGIC GOALS

### A. Guiding Principles and Major Strategies

To carry out the IRS strategic goals, the IRS has developed six guiding principles: (1) understand and solve problems from the taxpayer's point of view; (2) enable managers to be accountable with the requisite knowledge, responsibility, and authority to take action; (3) align measures of performance at all organizational levels; (4) foster open and honest communication; (5) insist on total integrity; and (6) demonstrate effective stewardship of assets and information entrusted to the IRS.<sup>47</sup> All IRS executives, managers, and employees are expected to manage and operate using these guiding principles in their interactions with both taxpayers and other employees.

In addition to guiding principles, the IRS has developed 10 "major strategies" to achieve its strategic goals. These strategies are:

- (1) Meet the needs of taxpayers;
- (2) Reduce taxpayer burden;
- (3) Broaden the use of electronic interactions;
- (4) Address key areas of noncompliance;
- (5) Stabilize traditional compliance activities;
- (6) Build a capability to deal effectively with the global economy;
- (7) Meet the special needs of the tax-exempt community;
- (8) Recruit, develop, and retain a qualified workforce;
- (9) Provide high-quality efficient, and responsive information services and shared support services; and
- (10) Promote effective asset and information stewardship by improving internal processes for information management, financial management, and asset management.

Each major strategy has within it operational priorities and improvement projects. Responsibility is assigned to the operating units for carrying them out. A major strategy may

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<sup>47</sup> IRS Strategic Plan at 37.

cross several organizational units or be confined to a single unit.<sup>48</sup> Highlights of several of the major strategies and their significant components are discussed below.

### **Meet the needs of taxpayers**

“Meeting the needs of taxpayers” involves offering higher quality, more readily available assistance to taxpayers. The IRS defines this strategy to mean that a taxpayer should receive quality service that is helpful based on his or her particular situation or need. Components of this strategy include:

- (1) Improving local service by making it more convenient for taxpayers and by improving the training and technology for employees assisting the taxpayer;
- (2) Providing higher quality phone service, Internet information, and correspondence;
- (3) Expanding the network of volunteers to assist in meeting filing assistance needs;
- (4) Making notices and letters more understandable;
- (5) Expanding service in Spanish and other languages;
- (6) Working with States and other Federal agencies to provide streamlined filing and payment options for small business; and
- (7) Using new technology to provide faster refunds and account resolution.<sup>49</sup>

### **Reduce taxpayer burden**

Reducing taxpayer burden highlights the IRS’s focus on its pre-filing efforts. The strategy is to address taxpayer problems as early as possible in the process and, through clear published guidance and education, prevent problems from occurring. According to the IRS, a key component of this strategy will be its partnerships with States, practitioners, and industry groups who are in regular contact with taxpayers.<sup>50</sup>

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<sup>48</sup> See Letter from the Honorable Charles O. Rossotti, Commissioner of Internal Revenue, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation, (April 27, 2001) (hereinafter “IRS Letter”) at 5-20 for a discussion of individual operating and functional unit initiatives.

<sup>49</sup> IRS Strategic Plan at 45-46.

<sup>50</sup> *Id* at 47.

Examples of this strategy include the Pre-Filing Agreement program,<sup>51</sup> the Industry Issue Resolution Program,<sup>52</sup> and the Comprehensive Case Resolution program,<sup>53</sup> which are available to taxpayers under the jurisdiction of the Large and Mid-Size Business Division.

### **Broaden the use of electronic interactions**

Electronic filing is generally thought to have advantages over paper returns for both the IRS and taxpayers. According to the IRS, taxpayers who file electronically are able to obtain their tax refunds faster than taxpayers who file paper returns. In addition, electronic filing is more accurate than paper filing. The error rate associated with processing paper returns is approximately 20 percent, half of which is attributable to the IRS and half to errors in taxpayer data. However, 77 percent of returns are still filed on paper. Because of the advantages of electronic tax administration, the IRS Reform Act provides that “the policy of Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least 80 percent of all tax returns in electronic form by the year 2007.”<sup>54</sup>

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<sup>51</sup> Under the Pre-Filing Agreement program, a Large and Mid-Size Business taxpayer may request examination and resolution of a factual issue involving well-established legal principles likely to be disputed in post-filing audits before the income tax return reporting the transaction is filed. The IRS charges a user fee ranging from \$1,000 to \$10,000, based on the taxpayer’s asset size. A closing agreement completes the process, binding both the taxpayer and the IRS as to the tax treatment of the transaction in question. *See* Rev. Proc. 2001-22 for the pre-filing agreement procedures.

<sup>52</sup> The Industry Issue Resolution program is still in the pilot stage with completion of the pilot planned for November 2001. The goal of the program is to provide guidance on frequently disputed industry issues to a number of affected Large and Mid-Size Business taxpayers, rather than through case-by-case rulings or post-filing audit determinations or rulings. Although the emphasis is on prospective guidance in the form of Revenue Procedures providing safe harbor rules, such guidance may also be applicable at the post-filing stage depending on the nature of issues. The guidance resulting from the Industry Issue Resolution process will apply to all taxpayers within an industry. *See* IRS Letter at 20-21.

<sup>53</sup> Under this pilot program Large and Mid-Size Business taxpayers could request resolution of all open issues for all open tax years under examination in Large and Mid-Size Business, in Appeals, or before the U.S. Tax Court. The goal of the Comprehensive Case Resolution program is to expedite resolution of all disputed issues by having all functions of the IRS making tax treatment determinations work together. Taxpayers would waive their Appeals *ex parte* communication rights and agree to meet the pilot Comprehensive Case Resolution processing timelines, including a requirement to complete the process in 12 months. A taxpayer may withdraw from the program within a set timeline. *See* IRS Letter at 21.

<sup>54</sup> IRS Reform Act sec. 2001.

The IRS intends to convert most interactions with taxpayers and practitioners to electronic means as rapidly as possible.<sup>55</sup> Examples of this strategy include the elimination of signatures on paper for electronically filed returns, and significantly increasing the number of forms that can be filed electronically.<sup>56</sup>

### **Address key areas of noncompliance**

In its strategic plan, the IRS notes that there are compliance concerns with respect to pass-through entity returns and trusts.<sup>57</sup> Further, the IRS states that the proliferation of corporate tax shelters presents an unacceptable and growing level of tax avoidance behavior.<sup>58</sup> The IRS also identifies unpaid trust fund taxes and erroneous earned income credit claims as continuing issues of concern.<sup>59</sup>

To address these concerns, the IRS plans to expand the data captured and transcribed from Schedule K-1 and match that information to the recipient taxpayer returns.<sup>60</sup> It also plans to increase the number of abusive trust cases under examination, and continue its focus on corporate tax shelters.

To address the unpaid trust fund taxes issue, the IRS will issue warning letters about the possible imposition of special trust fund tax filing and trust fund requirements. “In extreme cases, [the IRS will] place the taxpayer under special filing and deposit requirements and refer the taxpayer for civil and criminal action.”<sup>61</sup>

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<sup>55</sup> IRS Strategic Plan at 47.

<sup>56</sup> Statement of the Charles O. Rossotti, Commissioner of Internal Revenue, before the House Ways and Means Subcommittee on Oversight (April 3, 2001). For individual taxpayers seeking to file their returns electronically, the IRS added 22 forms and schedules for 2001 and will add the remaining 38 forms in 2002. In addition, for business the IRS introduced electronic filing options for Form 941 (“Employer’s Quarterly Federal Tax Return”) Form 940 (“Employer’s Annual Federal Unemployment (FUTA) Tax Record”) and Form 1065 (“U.S. Partnership Return of Income”). *See also* IRS Letter at 29-30, and 32.

<sup>57</sup> IRS Strategic Plan at 53.

<sup>58</sup> *Id.* at 53.

<sup>59</sup> IRS Strategic Plan at 54; IRS Letter at 85.

<sup>60</sup> IRS Letter at 13. Schedule K-1 is filed by partnerships, trusts, and S-corporations to provide information on the income and losses distributed by these entities to the individual partners, beneficiaries, and shareholders.

<sup>61</sup> IRS Strategic Plan at 54. *See also* IRS Letter at 85 (regarding criminal enforcement) and 93 (regarding civil enforcement).

With respect to the earned income credit, the IRS will continue its focus on earned income credit noncompliance, including preparer education and system changes to detect social security number errors.<sup>62</sup>

### **Stabilize traditional compliance activities**

As noted above, IRS enforcement activities have significantly declined, in part because compliance personnel have been diverted to filing season assistance.<sup>63</sup> Among other initiatives, the IRS intends to stabilize the total number of field examination and collection staff available through new hiring and to reduce the number of staff diverted to filing season assistance.<sup>64</sup>

A review of the Criminal Investigation Division by Judge William Webster (“the Webster Report”) noted that the percentage of cases that the Criminal Investigation Division investigated based on referrals from exam and collection had “dropped precipitously.”<sup>65</sup> To reverse this trend, the Criminal Investigation is taking steps to revive the Fraud Referral Program through partnerships and increased communication with the operating divisions. Further, Lead Development Centers will assist IRS special agents in developing and assigning investigative leads. IRS Chief Counsel will also be involved in criminal investigation cases from the beginning to provide guidance to the case agent and management officials. Previously, an agent could work on developing a case for a significant amount of time with no input from Chief Counsel only to have it not go forward when Chief Counsel found problems after the preparatory work was completed.<sup>66</sup>

### **Build a capability to deal effectively with the global economy**

To respond to the growing global economy, the IRS will develop an automated international classification system to assist in the early identification of issues and will work with the Department of Treasury and IRS Office of Chief Counsel to identify emerging issues, and

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<sup>62</sup> IRS Strategic Plan at 55. The IRS has also used its dependent database to identify questionable earned income credit claims and has implemented recertification requirements for taxpayers who have had their earned income credit claim previously denied by the IRS. IRS Letter at 74. For a discussion of the dependent database, *see* IRS Letter at 82-83.

<sup>63</sup> Internal Revenue Service, *Statement by IRS Commissioner Charles O. Rossotti on Audit and Collection Activity for Fiscal 2000* (February 15, 2001).

<sup>64</sup> IRS Letter at 91-92.

<sup>65</sup> William H. Webster, *Review of the Internal Revenue Service’s Criminal Investigation Division*, IRS Publication 3388 (April 1999).

<sup>66</sup> *See* Fred Stokeld, *Decline in Number of Audits Will Level Off, Rossotti Predicts*, Tax Notes Today, 2001 TNT 42-7 (March 2, 2001).

update and publish guidance.<sup>67</sup> It will also develop a shared global database to facilitate the treaty certification process.<sup>68</sup>

### **Meet the special needs of the tax-exempt community**

The IRS maintains an Exempt Organizations Master File containing public information on more than 1.4 million tax-exempt organizations.<sup>69</sup> According to the IRS, the database is neither accurate nor reliable. “Answering even simple questions, such as an organization’s location, exempt status, filing requirements, and contribution deductibility, is not possible in a reasonably short time.”<sup>70</sup>

To increase the accuracy of the Exempt Organizations Master File, the IRS will increase return imaging and introduce electronic filing for Form 990 (“Return of Organization Exempt from Income Tax”) filers.<sup>71</sup> However, the IRS has projected that electronic filing of Form 990 will not occur until fiscal year 2007.<sup>72</sup> The IRS acknowledges that, historically, it has underserved government entities. To increase service to these entities, the IRS is establishing the new Government Entities organization.<sup>73</sup> The IRS also plans to hire and train additional employees generally and in particular, strengthen the tax-exempt bond program by adding additional staff to increase regulatory efforts, including examination coverage.<sup>74</sup>

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<sup>67</sup> IRS Strategic Plan at 61-62.

<sup>68</sup> Some treaty partner countries require a U.S. government certification that the applicant for reduced tax rates in a tax treaty country is a citizen, corporation, partnership, or resident of the United States for purposes of taxation. See Internal Revenue Service, Publication 686, Certification for Reduced Tax Rates in Tax Treaty Countries (Rev. December 1998).

<sup>69</sup> IRS Strategic Plan at 63.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*; IRS Letter at 9-10.

<sup>72</sup> See, Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Volume II: Study of Disclosure of Provisions Relating to Tax-Exempt Organizations* (JCS-1-00), January 28, 2000, at 91, fn. 196.

<sup>73</sup> IRS Letter at 10.

<sup>74</sup> *Id.*; IRS Strategic Plan at 64.

## **B. Organizational Modernization**

### **Background**

At the time of Congressional consideration of the IRS Reform Act, the Commissioner had announced the broad outline of a plan to reorganize the structure of the IRS in order to help make the IRS more oriented toward assisting taxpayers and providing better taxpayer service. Prior to announcement of this plan, the IRS had a three-tier structure of district and regional offices and a national office. Thirty-three district offices and ten service centers administered the entire spectrum of taxpayers by defined geographical boundaries. Four regional offices presided over the districts, with one national office in Washington, D.C. at the top of the command chain.

The Congress found that organizational structure of the IRS was one of the factors contributing to the inability of the IRS to properly serve taxpayers. The Congress believed that a new structure focused taxpayers with similar needs would help enable the IRS to better serve taxpayers and provide the necessary level of services and accountability to taxpayers. In order to support the Commissioner in his efforts to modernize and update the IRS, the IRS Reform Act included a statutory direction for the Commissioner to eliminate or substantially modify the existing organizational structure and to establish organizational units to serve particular groups of taxpayers with similar needs.<sup>75</sup>

The IRS has made significant progress in implementing the new organizational structure. The IRS created four operating divisions to best serve taxpayers of similar needs: Wage and Investment; Small Business and Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities. There are also several functional units, including Appeals, the Taxpayer Advocate Service, Criminal Investigation and Communication and Liaison.

This new organization formally replaced the prior geographically based organizational structure on October 1, 2000. Top management is in place for each of the operating divisions and business units. The final stages of implementation, including the redistribution of workload, will require another two years (through fiscal year 2002). Below is discussion of each of the operating divisions and certain functional units.

### **Wage and Investment Division**

The Wage and Investment Division serves approximately 116 million taxpayers, including married taxpayers who file jointly, accounting for 88 million returns with wage and investment income only. Most of these taxpayers deal with the IRS only once a year when filing their returns. Eight Service Centers provide processing, account management, and compliance services.

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<sup>75</sup> IRS Reform Act sec. 1001.

### **Small Business and Self-Employed Division**

The Small Business and Self-Employed Division serves 45 million taxpayers, including small businesses, individuals with no wage income and individuals with both self-employment income and wage income. According to the IRS, this group has much more complex dealings with the IRS than wage and investment taxpayers. They have four to 60 transactions with the IRS each year. The Small Business and Self-Employed Division carries out its functions with a compliance field organization, including examination and collection groups, reporting to a manager handling multiple functions.<sup>76</sup>

### **Large and Mid-Size Business Division**

The Large and Mid-Size Business Division serves C corporations, S corporations, and partnerships with assets greater than \$5 million. At least two percent of these taxpayers interact with IRS compliance functions each year and the largest taxpayers deal with the IRS continuously. The Large and Mid-Size Business Division is predominantly a field organization that is structured into five industry groups.

### **Tax-Exempt and Government Entities Division**

The Tax-Exempt and Government Entities division serves three million entities including local community organizations, municipalities, universities, pension funds, state and local governments, and Indian tribal governments. This division also handles tax-exempt bond issues.

### **Appeals**

Appeals serves as a channel for taxpayers to contest an IRS compliance action. The mission of Appeals is “to resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the [IRS].”<sup>77</sup>

The new Appeals unit is organized into three operating units similar to the IRS operating divisions: Wage & Investment, Small Business/Self-Employed - Tax Exempt/Government Entities, and Large & Mid-Size Business.

The activities of the Small Business/Self-Employed - Tax Exempt/Government Entities unit of Appeals involve cases covering corporations with less than \$5 million in assets, collection issues, estate and gift tax cases, self-employed individuals, tax-exempt entities, and government entities. This unit also has responsibility for the current Records and Processing sections. Other program responsibilities include innocent spouse cases, Freedom of Information Act appeals, excise and employment taxes, and alternative dispute resolution of bankruptcy, dyed diesel fuel, and tax-exempt bond cases. Initially, all Wage and Investment Appeals unit cases will be processed by the Small Business/Self-Employed - Tax Exempt/Government Entities Appeals

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<sup>76</sup> IRS Strategic Plan at 83.

<sup>77</sup> IRS Letter at 15.

unit until the Wage and Investment unit of Appeals is operational. The Wage and Investment unit of Appeals is expected to become operational on October 1, 2001. The Large and Mid-Size Business unit of Appeals will cover corporate and partnership cases with assets greater than \$5 million with the most complex issues, particularly international issues.

### **Criminal Investigation**

Criminal Investigation investigates potential criminal violations of the Code and related financial crimes. The Webster report found that the then Criminal Investigation Division had “drifted from its primary mission of investigations of criminal violations of the Tax Code into the broader role of providing federal financial investigative expertise.”<sup>78</sup> Following the Webster report, Criminal Investigation developed an interim compliance strategy to assist in identifying, developing, and investigating cases. The Criminal Investigation Compliance Program Strategy has three components, legal source tax crimes (generally cases governed by the Code), illegal source financial crimes (includes Code and Title 18 violations, as well as money laundering), and narcotics related financial crimes (which includes both tax and money laundering violations). Criminal Investigation is also focusing on refund fraud and e-commerce fraud. It is developing a Fraud Detection Center to assist in this effort, as well as an Electronic Crimes Section.

### **Taxpayer Advocate Service**

The Taxpayer Advocate Service assists taxpayers in resolving problems that have not been resolved through prior contacts with the IRS or cannot be resolved through normal systemic processes. On March 12, 2000, the Taxpayer Advocate Service was established as a new organization. The new organization has two components, one segment dedicated to casework and the other dedicated to advocacy. It is structured to ensure that at least one Local Taxpayer Advocate is in each state.

### **Challenges facing the new IRS organizational structure**

#### Staffing

The new organizational structure places a greater emphasis on pre-filing services, such as education and outreach to help taxpayers comply with the tax law and get their returns correct the first time. The IRS notes that staffing has lagged behind the level necessary to perform the intended pre-filing services for both the Wage and Investment and Small Business/Self-Employed divisions.<sup>79</sup> Currently, the IRS is engaged in a recruitment effort to fill staff positions in the pre-filing components of these two divisions.<sup>80</sup>

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<sup>78</sup> William H. Webster, *Review of the Internal Revenue Service’s Criminal Investigation Division*, IRS Publication 3388 (April 1999).

<sup>79</sup> IRS Letter at 3.

<sup>80</sup> *Id.*

The IRS also has noted that resource limitations have affected the ability of the IRS to assist taxpayers promptly.<sup>81</sup> To address this issue, the IRS has increased reliance on automated services.<sup>82</sup>

### Consistent treatment of taxpayers

The IRS has experienced some difficulties in transitioning to the new organization. Each operating division is responsible for all of the interactions a taxpayer under its jurisdiction might have, regardless of geographic location. However, one division may be responsible for a program carried out by several divisions. For example, most collection procedures are the responsibility of the Small Business and Self-Employed division, but the Wage and Investment division shares responsibility for carrying out collection actions. Prior to the reorganization, the Collection Division would have been responsible for establishing procedures and the actual collection of tax. The IRS notes that it has had some difficulty having getting accustomed to having program responsibility assigned to one division and carried out by several others. “While the divisions are charged with addressing the unique needs of their taxpayer segments, we also need to ensure consistency of taxpayer treatment.”<sup>83</sup>

Outside groups also have noted a concern that taxpayers be treated uniformly among the operating divisions, as well as within the operating divisions. For example, the National Association of Enrolled Agents noted that its members are seeing inconsistent application of the equitable offer in compromise provisions.<sup>84</sup> In addition, the Tax Section of the American Bar Association, as well as the American Institute of Certified Public Accountants noted that some IRS personnel appear reluctant to grant requests of equitable relief under the innocent spouse provisions.<sup>85</sup> In addition, the Tax Section of the American Bar Association also expressed concern over the possibility for inconsistent treatment of similarly situated taxpayers. It used example the fact that the Large and Mid-Size Business Division consists of five industry groups.

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<sup>81</sup> IRS Letter at 67.

<sup>82</sup> *Id.*

<sup>83</sup> IRS Letter at 3.

<sup>84</sup> NAEA Letter.

<sup>85</sup> ABA Letter. “The experience of some practitioners [] is that some IRS personnel may be reluctant to grant requests for equitable relief under section 6015(f). Apparently some IRS personnel are placing a heavy burden on spouses to show that they did not have knowledge or reason to know of an underpayment of tax as a condition of their being granted equitable relief.” *Id.* “Also it is our impression that AICPA members are attempting to employ the IRC section 6015(f) equitable relief provisions for spouses, but without measurable results. CPAs appear to find the IRS’s interpretation of the equitable relief provisions too stringent.” AICPA Letter. The administration of the innocent spouse and offer in compromise provisions is discussed below in section IV.

It noted the potential for a lack of uniformity when each industry separately resolves issues common to taxpayers across all industry groups.<sup>86</sup>

#### Adjusting to shared services

Under the reorganized IRS, support functions such as information systems and facilities are centralized, rather than under the control of operational managers. The new structure has been viewed by some employees as more cumbersome and less effective than when these functions were under the control of the operation managers.<sup>87</sup> Nonetheless, the IRS believes this centralized system will eventually standardize key support operations and provide a mechanism for controlling costs.<sup>88</sup>

#### Developing reliable measures of compliance

The IRS needs information to assess whether its methods of encouraging voluntary compliance are achieving results, but it has not developed a plan for obtaining that information.<sup>89</sup> In part because the IRS lacks fundamental data on compliance levels, the General Accounting Office considers unpaid taxes to be a high-risk area for the IRS.<sup>90</sup>

### **C. Development of Organizational Performance Measures**

Historically, enforcement revenue has been a key measure of success at the IRS. The IRS Reform Act sought to change this focus through provisions such as the mandate for a new IRS mission statement and prohibiting the IRS from using tax enforcement results to evaluate any IRS employee or to impose or suggest production quotas or goals.<sup>91</sup> Accordingly, the IRS is changing its organizational performance measures to balance business results (both quantity and quality), customer satisfaction, and employee satisfaction. The IRS notes that enforcement revenues are not a measure of performance at either the strategic or operational level.<sup>92</sup>

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<sup>86</sup> ABA Letter.

<sup>87</sup> IRS Letter at 3.

<sup>88</sup> *Id.* at 4.

<sup>89</sup> General Accounting Office, Testimony Before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 3, 2001).

<sup>90</sup> *Id.*

<sup>91</sup> In addition, the Government Performance and Results Act of 1993 requires Federal agencies to establish a hierarchy of goals, objectives, and performance measures applicable to various organizational units within their agencies. Pub. L. No. 103-62 (1993).

<sup>92</sup> IRS Strategic Plan at 91. According to the IRS, among other actions, it is providing guidance and training to its managers and employees on the use of statistics and establishing

According to the IRS, the sole use of enforcement revenue at the strategic level is to measure the effectiveness of case selection for compliance activities.<sup>93</sup>

In September 1999, a balanced measures regulation was issued to formally establish the new performance management system.<sup>94</sup> The IRS implemented the balanced measures system for the Examination, Collection, and Customer Service in 1999.<sup>95</sup> In addition, balanced measures have been approved for Tax Exempt and Government Entities, Large and Mid-Size Businesses, Appeals, Taxpayer Advocate Service, Information Systems, Criminal Investigation, Appeals, and for additional Submission Processing and Customer Service product lines within the Wage and Investment and Small Business and Self-Employed operating divisions.<sup>96</sup> Balanced Measures for the remaining organizational units are scheduled for approval during fiscal year 2001.<sup>97</sup>

The General Accounting Office notes that last year, IRS also made progress by aligning its performance evaluation system for managers with its balanced measurement system, to clearly link their work to the mission and goals of the agency.<sup>98</sup> Further, IRS is beginning this year to hold managers accountable with a performance-based pay system.<sup>99</sup>

The General Accounting Office also has identified several challenges in this area. It found that the performance management system is most fully developed at the organization-wide level, is less well developed at the division level, and is weakest at the front-line level, where interactions with taxpayer occur.<sup>100</sup> According to the General Accounting Office, while most goals and action items to support operational objectives were clearly stated, they were not specific, measurable, or outcome-oriented.<sup>101</sup> The General Accounting Office also found that

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business units to conduct quarterly certifications of compliance with the prohibition on the use of statistics. IRS Letter at 68.

<sup>93</sup> IRS Strategic Plan at 91.

<sup>94</sup> *Id.* at 88.

<sup>95</sup> *Id.* at 93.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> General Accounting Office, Testimony Before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 3, 2001).

<sup>99</sup> IRS Letter at 41.

<sup>100</sup> *Id.*

<sup>101</sup> General Accounting Office, Testimony Before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on

while the IRS has revamped its evaluation system for managers, it still needs to similarly modify its evaluation system for front-line employees.<sup>102</sup> According to the General Accounting Office, this will require setting forth the performance standards for employee groups that are appropriate and measurable for their units and to align those performance standards to encourage behavior that supports the three strategic goals.<sup>103</sup>

#### **D. Technology Modernization**

##### **In general**

Commissioner Rossotti has observed that the “IRS is saddled with a collection of computer systems developed over a 35-year period. The most important systems that maintain all taxpayer records were developed in the 1960s and 1970s.”<sup>104</sup> In fact, taxpayer data “is stored and updated once a week on magnetic tape.”<sup>105</sup> IRS business systems modernization is a critical part of achievement of IRS strategic plans. Modernizing the IRS’s technological equipment requires a great deal of work; it is a massive project.

The IRS has been working on systems modernization efforts for over a decade. The road to modernization continues to present the IRS with challenges. In 1995, the General Accounting Office reviewed the IRS’s tax systems modernization projects, and it identified significant problems.<sup>106</sup> For example, the General Accounting Office found that, while the IRS had progressed in many actions designed to improved management of information systems, enhance its software development capability, and better define, perform, and manage its tax systems modernization, its efforts to modernize were at serious risk due to remaining pervasive management and technical weaknesses that were impeding modernization efforts.<sup>107</sup>

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Government Reform (April 3, 2001); General Accounting Office, *IRS Modernization: IRS Should Enhance Its Performance Management System*, (GAO-01-234, February 2001) at 4.

<sup>102</sup> General Accounting Office, Testimony Before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform (April 3, 2001).

<sup>103</sup> *Id.*

<sup>104</sup> Statement of Charles O. Rossotti, Commissioner, Internal Revenue Service, before the Subcommittee on Oversight, House Ways and Means Committee (April 3, 2001) at 17.

<sup>105</sup> *Id.*

<sup>106</sup> General Accounting Office, *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed* (GAO/AIMD-95-156, July 26, 1995) (“GAO Report 95-156”).

<sup>107</sup> *Id.* at 3.

The General Accounting Office again reviewed the IRS's tax systems modernization efforts in 1996.<sup>108</sup> At that time, the General Accounting Office found that the IRS had made further progress, but that none of the General Accounting Office recommendations had been fully implemented and that the IRS's progress was not adequate to correct the management and technical weaknesses. The General Accounting Office recommended that, until the IRS weaknesses were corrected, the Congress should consider limiting tax systems modernization spending to only cost-effective modernization efforts that: (1) support ongoing operations and maintenance; (2) correct IRS management and technical weaknesses; (3) are small, represent low technical risk, and can be delivered in a relatively short time frame; and (4) involve deploying already developed systems only if such systems have been fully tested, are not premature given the lack of completed architecture, and produce a proven, verifiable business value.<sup>109</sup>

In its 1996 report on tax systems modernization, the Treasury Department also found that, while the IRS had made some progress on systems modernization, modernization efforts had taken longer than expected, cost more than originally estimated, and delivered less functionally than originally envisioned. The Treasury Department study concluded that significant changes in the IRS management approach were needed, and that it was beyond the scope of IRS ability to develop and integrate tax systems modernization without expanded use of external expertise.<sup>110</sup> In 1997, the General Accounting Office again included IRS systems modernization on its list of "high-risk" areas.

The IRS has continued to make progress towards systems modernization. On May 15, 1997, the IRS issued its Modernization Blueprint detailing its information technology plan. The Blueprint had four principal parts: (1) systems life cycle; (2) business requirements; (3) functional and technical architectures; and (4) a sequencing plan. The General Accounting Office reviewed the Modernization Blueprint to determine whether it provided the foundation needed to develop or acquire modern systems and reported on the Blueprint in early 1998.<sup>111</sup> The General Accounting Office found that the Blueprint was a good start, but that it was not complete and failed to provide sufficient detail and precision for building and acquiring new

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<sup>108</sup> General Accounting Office, *Tax Systems Modernization: Tax Systems Modernization Under Way But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD-96-106, June 7, 1996) (GAO Report 96-106).

<sup>109</sup> GAO Report 96-106 at 3.

<sup>110</sup> Department of Treasury, *Report to House and Senate Appropriations Committees, Progress Report on IRS's Management and Implementation of Tax Systems Modernization* (May 6, 1996) at 1.

<sup>111</sup> General Accounting Office, *Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems* (GAO/AIMD/GGD-98-54, February 24, 1998) ("GAO Report 98-54").

systems. The IRS Chief Information Officer acknowledged that essential elements were missing from the Blueprint, and stated that he had been taking steps to address the missing elements.<sup>112</sup>

The IRS fiscal year 1998 appropriation included \$325 million for information technology<sup>113</sup> and, in response to concerns regarding IRS systems modernization efforts, restricted obligation of the funds until IRS submits to the Congress for approval a plan for expenditure that: (1) implements the IRS Modernization Blueprint submitted to Congress on May 15, 1997; (2) meets the information systems investment guidelines established by the Office of Management and Budget in the fiscal year 1998 budget; (3) has been reviewed and approved by the IRS's Investment Review Board, the Office of Management and Budget, and the Department of the Treasury's Modernization Management Board, and has been reviewed by the General Accounting Office; (4) meets the requirements of the May 15, 1997, IRS's Systems Life Cycle program; and (5) is in compliance with the acquisition rules, requirements, guidelines, and systems acquisition management practices of the Federal Government.<sup>114</sup> The fiscal year 1999 information technology appropriation of \$211 million included similar restrictions.<sup>115</sup> The fiscal year 2000 and fiscal year 2001 appropriations did not include amounts for information technology.<sup>116</sup>

In December 1998, the IRS awarded its prime systems integration services contract (also known as "PRIME"). In mid-1999, the IRS submitted its first expenditure plan requesting approximately \$35 million for modernization initiatives through October 1999. The General Accounting Office reported that the initial expenditure plan was an appropriate first step toward successful systems modernization and satisfied the conditions set forth by the Congress for the use of the funds.<sup>117</sup>

A second expenditure plan was not finalized before the original \$35 million was obligated. In December 1999, the IRS requested approval to obligate \$33 million as a stopgap funding measure until submission of the next expenditure plan.<sup>118</sup> The General Accounting Office reviewed this request and raised concerns regarding the lack of progress in completing

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<sup>112</sup> *Id.* at 2-3.

<sup>113</sup> The account from which systems modernization is to be funded was known as the Information Technology Investments Account (also known as ITIA).

<sup>114</sup> Pub. L. No. 105-61 (1997).

<sup>115</sup> Pub. L. No. 105-277 (1998).

<sup>116</sup> Pub. L. No. 106-58 (1999) and Pub. L. No. 106-554 (2000).

<sup>117</sup> General Accounting Office, *Tax Systems Modernization: Results of Review of IRS' Initial Expenditure Plan* (GAO/AIMD/GGD-99-206, June 15, 1999) ("GAO Report 99-206") at 3.

<sup>118</sup> GAO Report 00-144 at 12.

and implementing certain management controls and the risks associated with the plans to develop certain systems without such controls in place.<sup>119</sup> The IRS request was approved, and the IRS was directed to take actions to address the concerns raised by the General Accounting Office.

The General Accounting Office reports that the IRS has scaled back its new system development efforts, recognizing that it must first put in place the requisite modernization management capability.<sup>120</sup> On March 9, 2000, the IRS submitted a new expenditure plan requesting obligation of approximately \$176 million in funds. The plan includes provisions to address management weaknesses previously identified and emphasizes completing the enterprise architecture, implementing the enterprise lifecycle, and rescheduling projects to avoid problems. The General Accounting Office has noted that the March 9, 2000, plan addresses some longstanding weaknesses. However, the General Accounting Office will continue to designate IRS systems modernization as a high-risk program until management and technical weaknesses have been corrected.

In May 2000, the General Accounting Office stated that the IRS was just as challenged an agency at that time as it was when the IRS Reform Act was passed by the Congress. The General Accounting Office noted that the IRS continued to face serious operational issues in its two key mission areas: enforcement and customer service. For example, deficiencies in controls to properly manage billions of dollars in unpaid tax assessments have resulted in taxpayer burden and potentially billions of dollars in lost revenue to the government. Taxpayers also continue to be frustrated with their inability to reach the IRS by telephone. Once taxpayers are able to get through, IRS employees often provide slow service and incorrect answers to questions.<sup>121</sup>

The General Accounting Office has noted that the IRS has developed a massive modernization effort, which will likely take more than a decade to complete. This effort encompasses major changes to the IRS's organizational structure, performance management systems, information system, and business practices. The General Accounting Office has found that the IRS has begun to lay a foundation, which should facilitate changes to IRS business practices; however, substantial challenges remain in the areas of performance management and information systems modernization.

### **IRS Master File modernization**

The customer account data engine will provide a modern system for storing, managing, and accessing taxpayer records and accounts. This system will replace the existing master files and information processing system, and it will develop a central database for the management of

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<sup>119</sup> *Id.*

<sup>120</sup> *Id.* at 13.

<sup>121</sup> General Accounting Office, *IRS Modernization: Long-term Effort Under Way, but Significant Challenges Remain* (GAO/T-GGD/AIMD-00-154, May 3, 2000) (“GAO Report 00-154”) at 1-2.

taxpayer information and software systems that support different transactions using taxpayer account information. The IRS anticipates that the customer account data engine will fully deploy the individual master file by 2006. The planning to incrementally stage the business master file and information returns processing on the customer account data engine-individual master file footprint will start in October 2001.<sup>122</sup>

### **Computer security**

The IRS has noted that protecting taxpayer information is essential to the operation of a self-assessment tax system. In describing the steps the IRS has taken to prevent outsiders and insiders from breaching IRS security, the IRS has reported that, since 1997, the Office of Security (within the IRS), the General Accounting Office, and TIGTA have been actively involved in identifying and correcting security weaknesses throughout the IRS. The Office of Security conducts comprehensive security reviews of IRS facilities that identify both local and systemic weaknesses that require either local action or broader steps, such as policy guidance, revised operating procedures, training, or new technological approaches. Since 1997, the IRS has made major improvements in physical, data, and systems security assurance, although a major number of weaknesses remain. The General Accounting Office made note of IRS progress in this area in their most recent High Risk Update, in which it states that it has “made notable progress in improving computer security at its facilities, corrected a significant number of identified weaknesses, and established a Service-wide computer security management program that should, when fully implemented, help the agency effectively manage its security risks.”<sup>123</sup>

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<sup>122</sup> IRS Letter at 25.

<sup>123</sup> *Id.* at 25-26. Some of the IRS’s significant achievements include: (1) improvement of the security status of existing systems; (2) development of security architecture for the IRS modernized systems environment; (3) improvements to the established systems certification and accreditation; (4) continuing emphasis on the unauthorized access program (also known as “UNAX”); (5) creation of an enterprise computer systems incident response center (also known as “CSIRC”); (6) facilities upgrades to improve security; and (7) development of assessment tools and techniques that allow IRS to identify and prioritize areas of vulnerability in an objective, measurable manner. *Id.* at 26-28.

### III. DESCRIPTION AND ANALYSIS OF THE IRS BUDGET REQUEST FOR FISCAL YEAR 2002

#### A. In General

##### Administration's fiscal year 2002 IRS budget request

For fiscal year 2002, the Administration's IRS budget request totals \$9.276 billion and 99,116 full-time equivalent positions, not including funding and staffing for the earned income credit program. The fiscal year 2002 budget request reflects a \$580 million increase from the fiscal year 2001 appropriated level of \$8.696 billion and an increase of 1,843 full-time equivalent employees from the fiscal year 2001 proposed operating level of 97,273 full-time equivalent employees.<sup>124</sup>

In addition, the Administration's IRS budget request includes \$146 million and 2,236 full-time equivalent employees for the earned income credit compliance initiative, which reflects a \$1.319 million increase from the proposed operating level for fiscal year 2001, due to adjustments necessary to maintain current levels.<sup>125</sup> The fiscal year 2002 budgeted staffing levels would remain unchanged from the proposed operating level for fiscal year 2001.<sup>126</sup> The earned income credit program is funded outside the discretionary spending caps. Fiscal year 2002 is the fifth year of funding for this five-year compliance initiative. The compliance initiative provides for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce overclaims and erroneous filings associated with the earned income credit.

The IRS's overall budget request for fiscal year 2002, including funding and staffing for the earned income credit, totals \$9.422 billion and 101,352 full-time equivalent employees.<sup>127</sup>

##### IRS Oversight Board's fiscal year 2002 IRS budget recommendation

The IRS Oversight Board has stated that the Administration's fiscal year IRS 2002 budget request "does not adequately support the IRS Strategic Plan and provides inadequate support for technology modernization."<sup>128</sup> The IRS Oversight Board finds that the IRS operations budget should be increased by approximately six percent from fiscal year 2001 levels to account for inflation, mandatory cost increases, normal salary increases and promotions.

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<sup>124</sup> IRS Document 10968, *Fiscal Year 2001 Congressional Justification* (April 9, 2001) ("FY 2002 Justification") at SD-9, SD-12.

<sup>125</sup> FY 2002 Justification at EITC-1.

<sup>126</sup> *Id.*

<sup>127</sup> See Internal Revenue Service, *Budget in Brief, Fiscal Year 2002* (April 2001) ("IRS FY 2002 Budget in Brief") at 1.

<sup>128</sup> IRS Oversight Board Report at 5.

For fiscal year 2002, the IRS Oversight Board has recommended a total budget of \$10.260 billion, which includes \$8.992 billion for operations and \$1.268 billion for IRS modernization, which is a total of \$838 million more than is requested by the Administration. The IRS Oversight Board has presented its fiscal year 2002 budget recommendation in terms of the IRS's strategic goals and objectives, noting that the operations budget is directly linked to the strategic goals of the IRS. In its fiscal year 2002 budget recommendation, the IRS Oversight Board has allocated 40 percent to "Top Quality Service to All Taxpayers,"<sup>129</sup> or \$3.597 billion; 36 percent to "Productivity Through a Quality Work Environment,"<sup>130</sup> or \$3.237 billion; and 24 percent to "Top Quality Service to Each Taxpayer,"<sup>131</sup> or \$2.156 billion. The IRS Oversight Board's recommendation would represent approximately a 13 percent increase over fiscal year 2001 levels resources and funding for activities that provide service to each taxpayer. The IRS Oversight Board makes this recommendation because it believes that resources should go where taxpayers need help.

### **IRS objectives for the fiscal year 2002 budget request**

The IRS has noted that its fiscal year 2002 budget request results from strategic and program delivery gaps in IRS resources. Examples of such gaps include taxpayers' need for assistance in complying with tax laws, unpaid tax debts that remain uncollected, and noncompliance and underreporting. The IRS acknowledged its commitment to increased program delivery, including filing season assistance, expansion of key programs such as Electronic Tax Administration, declines in the backlogs in programs such as offers in compromise and collection due process, improvements in information services, progress in correcting security and financial control weaknesses, and fully implementing technical training for essential occupations such as exam and customer service.<sup>132</sup>

The IRS plans to address certain strategies as one of the significant steps to IRS modernization. These strategies include:

- filling front-line pre-filing and taxpayers assistance positions in the organizational design;

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<sup>129</sup> "To Quality Service to All Taxpayers" includes: (1) increasing fairness of compliance and (2) increasing overall compliance. This strategic goal includes the earned income credit budget request of \$146 million. *Id.* at 14.

<sup>130</sup> "Productivity Through a Quality Work Environment" includes: (1) increasing employee job satisfaction and (2) holding agency employment stable while economy grows and service improves. This strategic goal includes the mandated information systems special pay increases of \$9 million and excludes modernization and improvements projects. *Id.*

<sup>131</sup> "To Quality Service to Each Taxpayer" includes: (1) making filing easier, (2) providing first quality service to each taxpayer needing help with his or her return or account, and (3) providing prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due. *Id.*

<sup>132</sup> FY 2002 Justification at SD-4 through SD-5.

- increasing the level of service access for telephone service;
- replacing attrition in front-line compliance positions;
- increasing front-line compliance services staffing for document matching and telephone collections;
- reducing the number of compliance full-time equivalent employees diverted to filing season details, thereby increasing net full-time equivalent employees for compliance;
- centralizing processing of most offers in compromise to reduce the drain on front-line collections staff;
- moving most innocent spouse cases to the Wage and Investment unit to reduce the drain on front-line Small Business Self-Employed exam staff;
- completing the Tax Exempt and Government Entities organizational design for government entities;
- initiating document matching for Forms K-1;
- improving operational efficiency through modernized business systems coming on line; and
- planning for normal workload increases.<sup>133</sup>

The \$580 million increase in the Administration's IRS's fiscal year 2002 budget request from its projected fiscal year 2001 operating level includes two broad categories: maintaining current service levels and modernization. For maintaining current service levels, the IRS has requested a total of \$356 million, and for modernization, the IRS has requested a total of \$224 million.<sup>134</sup>

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<sup>133</sup> FY 2002 Justification at SD-5 through SD-9.

<sup>134</sup> For its progress in modernization, the IRS has requested \$325 million for business systems modernization and a reduction of \$101 million for the non-recurrence in organizational modernization funds, which the IRS finds will decline by \$101 million in fiscal year 2002 and end in fiscal year 2003.

## **B. Funding to Maintain Current Operating and Service Levels**

### **In general**

For maintaining current service levels, the IRS has requested \$356 million for fiscal year 2002, which includes \$325 million for pay cost, benefits, and non-labor increases, a combined \$88 million for STABLE and counterterrorism staff annualization, and a \$57 million reduction for the absorption of non-pay expenditures, as well as other non-discretionary cost increases.

### **Pay, benefit, and non-labor increases**

The IRS's budget request includes \$325 million for non-pay inflation and statutory pay and benefit increases.<sup>135</sup> The IRS notes that it is a labor-intensive organization and that a stable workforce is critical to achieving its mission.<sup>136</sup> The IRS further states that, in order to maintain its current operations, complete a successful filing season, and oversee tax administration and organizational modernization, it must have the resources to pay for the increased costs associated with statutory pay increases.<sup>137</sup>

### **STABLE and counterterrorism initiatives annualization**

The Staffing Tax Administration for Balance and Equity ("STABLE") initiative is designed to stabilize and strengthen tax compliance and customer service. For this program, the IRS has requested \$86.4 million and 1,822 full-time equivalent employees for fiscal year 2002.<sup>138</sup> The IRS notes that the requested staffing increases will improve toll-free service and reverse the declines in audit coverage that the IRS has experienced over the past several years. In addition, the IRS has requested \$1.4 million and 21 full-time equivalent employees to complete funding for the IRS Criminal Investigation portion of the National Initiative against Counterterrorism.<sup>139</sup>

The IRS Oversight Board also believes that full funding for the STABLE initiative is important. Thus, the IRS Oversight Board would ensure that the budget allow for the completion of the hiring of the 3,800 staff to enable to IRS to begin addressing the decline in taxpayer service, audits, and other compliance programs that have occurred during the past few years.

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<sup>135</sup> FY 2002 Justification at SD-10.

<sup>136</sup> *Id.*

<sup>137</sup> FY 2002 Justification at SD-10.

<sup>138</sup> *Id.* at SD-13.

<sup>139</sup> *Id.* at SD-10.

## **Program offsets**

The IRS has proposed to offset \$57 million to account for projected inflation for non-pay expenditures, as well as other non-discretionary cost increases. The IRS notes that these costs can be offset through improved resource management. For example, IRS management is expected to be more selective in incurring costs such as travel and contracted services and to look for opportunities to improve the IRS's purchasing power, for example, by combining procurements.<sup>140</sup>

### **C. Funding to Support IRS Systems Modernization**

#### **In general**

The IRS notes that most costs associated with administering the tax system are not part of its budget; rather, these costs are borne by taxpayers. Taxpayers must spend time and money in preparing their tax returns, as well as dealing with the IRS, which attempts to help taxpayers and administer Federal taxes with “extraordinarily old and poorly integrated systems.”<sup>141</sup> The IRS has reiterated its desire to reengineer the way its conducts business with taxpayers, who should receive world-class service.<sup>142</sup>

The IRS has requested an increase of \$224 million for modernization of the IRS, which encompasses both a \$325 million increase for the IRS's investments in new technology and to enable the IRS to continue the momentum of business systems modernization and a \$101 million decrease in funds for organization modernization, a process that is ending.<sup>143</sup>

#### **Business systems modernization**

The IRS has found that its computer systems, which were developed in the 1960s and 1970s, are so outdated that they do not allow the IRS to meet its modern business needs. Moreover, delays in modernizing IRS's tax administration business systems result in the sustaining of these outdated systems that do not efficiently serve taxpayers.<sup>144</sup>

The IRS has requested a total of \$397 million for business systems modernization (also known as BSM), which reflects a \$325 million increase from the \$72 million appropriated in fiscal year 2001.<sup>145</sup> Formerly known as the Information Technology Investment Account (also known as ITIA) the business systems modernization appropriation provides for reengineering

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<sup>140</sup> *Id.* at SD-10 through SD-11.

<sup>141</sup> *Id.* at SD-11.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> IRS FY 2002 Budget in Brief at 3.

<sup>145</sup> FY 2002 Justification at SD-11; FY 2002 Budget in Brief at 2.

business practices and acquiring new technology. The IRS is using a formal method to prioritize, approve, fund, and evaluate its portfolio of business systems modernization investments. The IRS finds that this methodology enforces a documented, repeatable, and measurable process for managing investments throughout their life cycle. Investment decisions are approved by the IRS Core Business System Executive Steering Committee, which is chaired by the Commissioner of Internal Revenue.

The business systems modernization program is comprised of five categories. These include: (1) Program Management,<sup>146</sup> (2) Core Infrastructure Support Projects,<sup>147</sup> (3) Data Infrastructure Projects,<sup>148</sup> (4) Existing Business Projects,<sup>149</sup> and (5) New Business Projects.<sup>150</sup>

The IRS has indicated that its business systems modernization will provide improved access to information and tax data, more accurate information by the IRS to taxpayers, speedier responses by the IRS to taxpayers, and more timely IRS-initiated actions.<sup>151</sup>

The IRS thoroughly reviewed its tax system work streams as part of a business process reengineering effort. This process, which the IRS refers to as Tax Administration Vision and Strategy (also known as TAVS) developed a vision of future business practices for each stream, creating operating models that bundle sets of capabilities that meet the differing needs of customer segments at different stages in the taxpayer lifecycle. The Tax Administration Vision

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<sup>146</sup> Program Management includes: (1) Prime Program Management Office, (2) Enterprise Life Cycle, (3) Configuration Management, (4) Business System Modernization Office TIPSS support to QA, (5) Federally Funded Research & Development Center (MITRE), and (6) Architectural Engineering Office. FY 2002 Justification at BSM-11.

<sup>147</sup> Core Infrastructure Support Projects includes: (1) Security and Technology Infrastructure Releases (STIR), (2) Telecommunications Near-Term (formerly TESP), (3) STIR (Infrastructure Shared Services), (4) Enterprise Systems Management, (5) Solutions Demonstration Laboratory, (6) Virtual Development Environment, and (7) Enterprise Integration & Test Environment. FY 2002 Justification at BSM-11.

<sup>148</sup> Data Infrastructure Support Projects include: (1) Customer Account Data Engine (“CADE”) (IMF simple), (2) CADE (IMF complex), (3) CADE (BMF), (4) Information Returns Processing Modernization, (5) Enterprise Data Warehouse (Includes Custodial Accounting Project & Decision Analytics), and (6) Integrated Financial Services. FY 2002 Justification at BSM-11.

<sup>149</sup> Existing Business Projects include: (1) Customer Communications 2002 and (2) E-Services. FY 2002 Justification at BSM-11.

<sup>150</sup> New Business Projects include: (1) Workload Planning and Control, (2) E-Services 2003, (3) HRConnect, (4) Customer Account Management Individual and Self, (5) Filing and Payment Compliance, (6) Reporting Compliance - Individual, and (7) Taxpayer Education - Indirect. FY 2002 Justification at BSM-11.

<sup>151</sup> IRS FY 2002 Budget in Brief at 4.

and Strategy process has identified the business systems and processes that would most quickly provide benefits to taxpayers:<sup>152</sup>

| <b>The IRS seeks to change from the following business system or process...</b>  | <b>To...</b>  |
|--|---|
| Information requests: <ul style="list-style-type: none"> <li>• paper average: 23 days</li> <li>• e-mail average: 4 days</li> <li>• telephone level of service: 53 percent (FY 1999)</li> </ul> | Information requests correctly routed and fulfilled at the time of request.                     |
| Taxpayer cannot resolve problems without IRS staff <ul style="list-style-type: none"> <li>• tax law quality 72 percent</li> <li>• account quality 59 percent</li> </ul>                        | Robust “self help” capabilities and third-party relationships help to prevent/correct problems. |
| Refunds in 5 - 7 weeks.  | Refunds in 2 - 3 days.  |
| Audits not started until 14 - 20 months after return is filed.   | Tax returns selected for audit within same filing season.                                       |
| Up to 30 percent of audits result in “No Change” to the return.  | Reduce unnecessary audits so as to cut “No Change” closings by one half.                        |
| Account inquiries at 40 percent first time resolution.   | Account inquiries at 80 percent resolution.   |
| Time to collect outstanding balances: average 2.5 years.   | Collection of outstanding balances: average 6 months.   |
| Multiple points of data entry.   | Single point of data entry.   |

<sup>152</sup> Table adapted from IRS FY Budget in Brief at 5.

| <b>The IRS seeks to change from the following business system or process...</b>                      | <b>To...</b>  |
|--|---|
| Limited reporting and access to data.  | Manager and employee self service access to data and reporting capabilities.                      |
| Limited measurement capabilities.  | Automated capabilities for enhanced and focused measurements.                                     |
| Multiple stand alone systems that are not integrated.  | One integrated data warehouse for HR data.  |
| Employee skills and competencies not linked to positions, vacancies, training, and employee records. | Skills and competency database to link positions, training, job vacancies, employee records, etc. |

**IRS Oversight Board’s budget recommendation for systems modernization**

The IRS Oversight Board has recommended \$871 million more funding for business systems modernization than the Administration has requested, in part because the IRS Oversight Board has recommended two-year funding for business systems modernization. The IRS Oversight Board is concerned that business systems modernization (former ITIA) will reach a zero balance by the end of fiscal year 2001, and that with two-year funding, modernization can continue without interruption. Thus, the IRS Oversight Board recommends that funding for fiscal year 2002 for Modernization and Improvement Programs be \$1.268 billion, of which \$1 billion of the funding would relate to systems modernization, \$131 million would be allocated to organization modernization, and \$137 million would be allocated to other improvement projects.<sup>153</sup>

The IRS Oversight Board has recommended that \$450 million of the \$1 billion appropriation for systems modernization be released for fiscal year 2002 and \$550 million be released for fiscal year 2003. The fiscal year 2002 amount is \$53 million more than the Administration requested, because the IRS Oversight Board believes that such funding will foster completing modernization as quickly as possible.

The IRS Oversight Board has also noted that the fiscal year 2002 budget for organizational modernization would decrease by \$101 million.<sup>154</sup> The remaining budget of \$131

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<sup>153</sup> IRS Oversight Board Report at 21-22.

<sup>154</sup> *Id.* at 18.

million for this item reflects buyouts for retiring employees, moving expenses, and improvements to existing systems to support the new organization. In addition, the IRS Oversight Board recommends an increase of \$97 million for other improvement programs, such as computer desktop and laptop replacements, improvements in existing systems, field site renovations, and shared services center furniture replacement.<sup>155</sup>

#### **D. Financial Audit of IRS Fiscal Year 2000 Financial Statements**

The General Accounting Office recently presented the results of its audit of the IRS's principal financial statements for fiscal year 2000. For the first time since the General Accounting Office started its annual audit of the IRS in 1992 in accordance with the Chief Financial Officers Act of 1990,<sup>156</sup> as expanded by the Government Management Reform Act of 1994,<sup>157</sup> the General Accounting Office expressed an unqualified opinion on all IRS financial statements.<sup>158</sup> The General Accounting Office's audit of IRS financial statements for fiscal year 1999, for example, resulted in an unqualified opinion on its custodial activity statement, a qualified opinion on its balance sheet, and a disclaimer that no opinion could be issued on the remaining IRS financial statements. In prior years, the General Accounting Office's audit reports were less favorable.

Commissioner Rossotti recently testified that the General Accounting Office rendered unqualified opinions due to the combined efforts of both the IRS and the General Accounting Office.<sup>159</sup> Commissioner Rossotti also indicated that the IRS has made significant improvements in several areas, which contributed to the IRS's success in obtaining unqualified opinions as to each financial statement. These improvements include:

- implementing reconciliation procedures for IRS fund balances and ensuring that prompt review and reconciliation was performed;
- revising its reporting and disclosure for the statement of net cost to properly classify IRS programs;
- improving management of property and equipment inventories;

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<sup>155</sup> *Id.*

<sup>156</sup> Pub L. No. 101-576 (1990).

<sup>157</sup> Pub L. No. 103-356 (1994).

<sup>158</sup> The IRS financial statements include its balance sheet, net cost, changes in net position, budgetary resources, financing, and custodial activity. General Accounting Office, *Financial Audit: IRS' Fiscal Year 2000 Financial Statements* (GAO-01-394, March 2001) ("GAO Report 01-394") at 3.

<sup>159</sup> Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 3, 2001).

- improving its review and management of suspense accounts;
- reducing the number of computer security weaknesses;
- addressing issues related to safeguarding taxpayer data; and
- improving its ability to substantiate unpaid assessments.

Despite its unqualified opinions, the General Accounting Office continues to identify many material weaknesses in the IRS's internal controls. These weaknesses in internal controls include: (1) safeguarding of assets, (2) lack of current and reliable ongoing information from which to make decisions, (3) inability to manage unpaid assessments, (4) weaknesses in controls over tax refunds, property, and equipment, (5) inadequate budgetary controls, and (6) weaknesses in computer security.

## **IV. OTHER MATTERS ADDRESSED BY THE IRS REFORM ACT**

### **A. IRS Oversight Board**

The IRS Reform Act created the IRS Oversight Board. The IRS Oversight Board began operations in September 2000. Generally, the IRS Oversight Board oversees the IRS's administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws.<sup>160</sup> Specific responsibilities of the IRS Oversight Board include reviewing and approving the IRS's strategic plans and operational functions (such as modernization, outsourcing, training, and education). The IRS Oversight Board also is to recommend candidates for appointment as IRS Commissioner, and may recommend whether the Commissioner should be removed. The Commissioner's selection, evaluation, and compensation of senior executives also are to be reviewed by the IRS Oversight Board. In addition, any major reorganization of the IRS is to be reviewed and approved by the IRS Oversight Board.

The IRS Oversight Board reviews and approves budget requests prepared by the Commissioner to ensure that the budget request supports IRS annual and long-range strategic plans.<sup>161</sup> The IRS Oversight Board submits such budget requests to the Secretary of the Treasury, who submits the request to the President, who in turn submits it, without revision, to Congress together with the President's annual budget request for the IRS for the fiscal year. The President is not precluded from submitting his own budget for the IRS.

The IRS Oversight Board consists of nine members: seven private citizens who serve on a part-time basis, the Commissioner, and the Secretary of the Treasury. Since becoming operational, the IRS Oversight Board has been meeting for two days every two months. Much of the IRS Oversight Board's initial activities have been learning about IRS operations and identifying problem areas. The IRS Oversight Board held its first public meeting in March 2001 and heard statements about the IRS budget and IRS Strategic Plan from organizations that work with and advise the IRS. In its interim report, the IRS Oversight Board identified as significant problems that IRS customer service is still inadequate, the level of enforcement activities is too low, IRS computer systems are outdated, and IRS employee morale and job satisfaction are poor.<sup>162</sup> So far, the IRS Oversight Board has organized three committees: Modernization, Personnel and Organization, and Performance Management. In addition, the IRS Oversight Board has started to develop a strategic plan, which will detail the manner of the IRS Oversight Board's operations and the areas of IRS operations that the IRS Oversight Board will focus on.

The IRS Oversight Board reviewed and approved the IRS's Strategic Plan. In its Interim Report, the IRS Oversight Board strongly supports the mission and goals defined in the IRS Strategic Plan and believes that the framework described in the plan is logical and appropriate and represents the best way forward. However, the IRS Oversight Board recognizes that meeting

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<sup>160</sup> Sec. 7802(c) and (d).

<sup>161</sup> Sec. 7802(d)(4).

<sup>162</sup> IRS Oversight Board Report at 8-9.

the goals of the plan will be difficult, will take time, and will require the continuous support of the Administration and Congress.<sup>163</sup>

The IRS Oversight Board reviewed the IRS's proposed budget for fiscal year 2002 to be sure that the budget was consistent with and supported the IRS Strategic Plan. The IRS Oversight Board formally approved the IRS's budget on February 26, 2001,<sup>164</sup> which differs in significant respects from the budget submitted to Congress by the Administration.<sup>165</sup>

The IRS Oversight Board also has been participating actively in the evaluation of the Taxpayer Advocate and advising the Secretary of the Treasury on this appointment, participating in the selection of a new Chief Information Officer, and building a professional staff for the IRS Oversight Board. The IRS Oversight Board recently named its first permanent staff director, whose primary initial task will be to build the IRS Oversight Board staff to six to twelve people.

## **B. National Taxpayer Advocate**

### **Background and provisions of the IRS Reform Act**

The IRS created the Problem Resolution Program in 1976. The purpose of the program was to provide an independent means by which taxpayer problems were promptly and properly handled. In 1979, the IRS created the position of the Taxpayer Ombudsman to head the program. In 1996, the Taxpayer Bill of Rights 2 replaced the Taxpayer Ombudsman with the Taxpayer Advocate.<sup>166</sup> The Taxpayer Advocate was expected to represent taxpayer interests independently in disputes with the IRS. The IRS Reform Act renamed the Taxpayer Advocate the National Taxpayer Advocate.<sup>167</sup> The National Taxpayer Advocate supervises the Office of the Taxpayer Advocate.

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<sup>163</sup> *Id.* at 12.

<sup>164</sup> Letter from Larry R. Levitan, Chairman IRS Oversight Board, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (March 15, 2001).

<sup>165</sup> As discussed in more detail in Part III. above, the IRS Oversight Board supports increased funding for modernization (the Information Technology Investment Account) and \$54 million in funding for certain computer upgrades that the Administration's budget does not provide. Further, the IRS Oversight Board believes that full funding of Staffing Tax Administration for Balance and Equity (STABLE) will counter the decrease in audit coverage and notes that the Administration's proposed funding for STABLE would provide for only an increase of 2,500 professionals. IRS Oversight Board Report at 21-22.

<sup>166</sup> The Commissioner of Internal Revenue appointed the Taxpayer Advocate.

<sup>167</sup> The IRS Reform Act now requires that the Secretary of the Treasury, after consultation with the Commissioner and the IRS Oversight Board, appoint the National Taxpayer Advocate. The National Taxpayer Advocate is required to have experience in customer service, tax law, and representing individual taxpayers. Compensation for the National Taxpayer Advocate is at the highest rate of basic pay established for the Senior Executive

The Office of the Taxpayer Advocate has four principal functions:

- (1) to assist taxpayers in resolving problems with the IRS;
- (2) to identify areas in which taxpayers have problems in dealing with the IRS;
- (3) to propose changes in the administrative practices of the IRS to mitigate such problems; and
- (4) to identify potential legislative changes which may be appropriate to mitigate such problems.

The IRS Reform Act established a system of local Taxpayer Advocates that report to the National Taxpayer Advocate or her delegate. Local Taxpayer Advocates are to be independent of the IRS' examination, collection, and appeals functions. Local Taxpayer Advocates also are to be employees of the Office of the Taxpayer Advocate. The National Taxpayer Advocate appoints Local Taxpayer Advocates. With the Commissioner, the National Taxpayer Advocate must develop career paths for local Taxpayer Advocates choosing to pursue a career within the Office of the Taxpayer Advocate.

The National Taxpayer Advocate monitors the coverage and geographic allocation of local taxpayer advocate offices and ensures that at least one local advocate is available for each State.<sup>168</sup> Prior to the reorganization of the Office of the Taxpayer Advocate, the IRS had a taxpayer advocate in each of the four regional offices. Each of the 33 district offices, 30 former district offices, and 10 service centers has local advocates. The National Taxpayer Advocate also must ensure that local telephone numbers for each office are published and available to taxpayers served by the office.<sup>169</sup> Additionally, the National Taxpayer Advocate must develop guidance to be distributed to all IRS officers and employees that outlines the criteria for referring taxpayer inquiries to local taxpayer advocate offices.<sup>170</sup>

The IRS Reform Act also expanded the National Taxpayer Advocate's ability to issue Taxpayer Assistance Orders. A taxpayer can request a Taxpayer Assistance Order if the taxpayer is suffering or about to suffer a "significant hardship" from tax law administration.<sup>171</sup> A

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Service. For the two-year period preceding appointment, the National Taxpayer Advocate must not have been an IRS officer or employee. After leaving the Office of the National Taxpayer Advocate, the National Taxpayer Advocate cannot accept employment with the IRS for five years.

<sup>168</sup> Sec. 7803(c)(2)(C)(i).

<sup>169</sup> Sec. 7803(c)(2)(C)(iii).

<sup>170</sup> Sec. 7803(c)(2)(C)(ii).

<sup>171</sup> Sec. 7811(a)(1)(A). Significant hardship is deemed to occur if one of four factors exists: (1) there is an immediate threat of adverse action; (2) there has been a delay of more than 30 days in resolving the taxpayer's problems; (3) the taxpayer will have to pay significant costs (including fees for professional services) if relief is not granted; or (4) the taxpayer will suffer

Taxpayer Assistance Order may require the IRS to release property of the taxpayer that has been levied upon, to cease any action or take any action as permitted by law, or refrain from taking any action with respect to the taxpayer. The IRS has recently clarified the guidelines for issuing Taxpayer Assistance Orders.<sup>172</sup>

The Code requires the National Taxpayer Advocate to submit two reports annually to the Committee on Ways and Means of the House of Representatives and to the Senate Committee on Finance.<sup>173</sup> The National Taxpayer Advocate submits the reports directly to the Congressional committees without prior review by the Commissioner, the Secretary, or any officer or employee of the Treasury, the IRS Oversight Board, or the Office of Management and Budget.<sup>174</sup>

The first report, due June 30th of each year, covers the Office of the Taxpayer Advocate's objectives for the fiscal year beginning in that calendar year. Besides statistical information, the report must contain a full and substantive analysis of the objectives.

The second report, due December 31st of each year, concerns the activities of the Office of the Taxpayer Advocate.<sup>175</sup> Generally, the report must cover initiatives taken to improve taxpayer services and problems encountered, as well as the actions taken to resolve them and the results. The report also must cover the 20 most serious problems experienced by taxpayers. In addition, the IRS Reform Act requires the report to identify the ten most litigated issues for each category of taxpayer and the areas of the tax law that impose significant compliance burdens on taxpayers or the IRS. The report must include any recommendations received from individuals with the authority to issue Taxpayer Assistance Orders, as well as any Taxpayer Assistance Orders that have not been promptly honored by the IRS. The report also must set forth recommendations for administrative and legislative action to resolve problems encountered by taxpayers.

### **Organization of the Office of the Taxpayer Advocate**

The reorganized Office of the Taxpayer Advocate ("Taxpayer Advocate Service") became official on March 12, 2000. The field organization consists of nine Area Taxpayer Advocate directors, seven of whom oversee casework by Local Taxpayer Advocates in assigned territories and two of whom oversee casework from Service Center Advocates. Seventy-four Local Taxpayer Advocates report to the Area Taxpayer Advocate Directors and are responsible

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irreparable injury, or a long term adverse impact if relief is not granted. Sec. 7811(a)(2). The National Taxpayer Advocate may also issue a Taxpayer Assistance Order if the taxpayer meets requirements to be set forth in regulations. Sec. 7811(a)(1)(B).

<sup>172</sup> Internal Revenue Service, *IRS Expands Authority for Taxpayer Advocate Service*, IR-2001-12 (Jan. 24, 2001).

<sup>173</sup> Sec. 7803(c)(2)(B).

<sup>174</sup> Sec. 7803(c)(2)(B)(iii).

<sup>175</sup> Sec. 7803(c)(2)(B)(ii)(I) through (XI).

for handling taxpayer cases at the local level.<sup>176</sup> The Area Taxpayer Advocate Directors report to the National Taxpayer Advocate.<sup>177</sup> Caseworkers also have been moved into the local Taxpayer Advocate organization.<sup>178</sup> A career path has been established for these workers to allow for professional development and advancement.<sup>179</sup>

In addition to caseworker positions, the National Taxpayer Advocate has created Operating Division Taxpayer Advocate positions to work within the new IRS organizational structure.<sup>180</sup> The primary responsibility of the Operating Division Taxpayer Advocate is to provide systemic analysis and advocacy, as opposed to performing casework.<sup>181</sup>

The National Taxpayer Advocate receives legal assistance from an executive-level Chief Counsel attorney assigned as the Counsel to the National Taxpayer Advocate.<sup>182</sup> The Counsel to the National Taxpayer Advocate has authority to hire four senior attorneys to provide the National Taxpayer Advocate and the immediate office with legal support.<sup>183</sup> Since its inception in November 1998, the Counsel's office has assisted the National Taxpayer Advocate with over 120 cases or projects.<sup>184</sup>

### **National Taxpayer Advocate annual report**

According to the National Taxpayer Advocate's most recent annual report,<sup>185</sup> the National Taxpayer Advocate has turned its attention away from modernizing its organizational structure and toward conducting its day-to-day business as the newly modernized and independent Taxpayer Advocate Service.<sup>186</sup> The National Taxpayer Advocate successfully

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<sup>176</sup> Previously, local Taxpayer Advocates reported to and received evaluations from IRS district and service center directors.

<sup>177</sup> See Internal Revenue Service, National Taxpayer Advocate Annual Report to Congress for Fiscal Year 1999, Publication 2104 (December 1999), VI-1.

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> *Id.* at VI-3.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> See Internal Revenue Service, *National Taxpayer Advocate Annual Report to Congress for Fiscal Year 2000*, Publication 2104 (December 2000) (hereinafter "National Taxpayer Advocate FY 2000 Report").

<sup>186</sup> *Id.* at ii.

reassigned its casework from employees working in IRS Operations to its newly hired and trained staff.<sup>187</sup>

The National Taxpayer Advocate report identified the following areas as some of the most serious problems identified by individual and business taxpayers, tax practitioners, and IRS employees:

- (1) complexity of the tax law (individuals and businesses);
- (2) clarity and tone of IRS communications;
- (3) inability to access the IRS toll-free number;
- (4) burden on small business;
- (5) administration of the earned income credit;
- (6) lack of one-stop service;
- (7) lack of acknowledgement of correspondence and payments;
- (8) penalty administration;
- (9) offer-in-compromise issues; and
- (10) misapplied payments.<sup>188</sup>

The National Taxpayer Advocate report ranks the general category of penalties (accuracy-related and failure to file or pay) and interest as the most litigated tax issue.<sup>189</sup> In addition to penalties and interest, the most litigated tax issues include: court procedures; the deductibility of business expenditures; filing status; earned income credit; dependency exemptions; the definition of gross income (inclusions and exclusions); accounting methods; record keeping and documentation (substantiation); statute of limitations; court authority for credits, refunds, and abatement; self-employment issues; independent contractor versus employee status; and last known address and notice of deficiency issues.<sup>190</sup> Among the most litigated tax issues, the National Taxpayer Advocate noted that the deductibility of business expenditures, the definition of gross income, accounting methods, and record keeping and

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<sup>187</sup> *Id.*

<sup>188</sup> *Id.* at 3.

<sup>189</sup> *Id.* at 66.

<sup>190</sup> *Id.* at 70.

documentation present the most significant compliance problems for taxpayers due to complexity.<sup>191</sup>

The National Taxpayer Advocate reported that during fiscal year 2000, the Taxpayer Advocate Service independently reviewed and took action to resolve over 256,000 cases.<sup>192</sup> The National Taxpayer Advocate report listed the top ten sources of Taxpayer Advocate Service casework as refund issues, processing of claims and amended returns, processing of original returns, audit reconsiderations, abatement of penalties, revenue protection, payment and credit problems, examination of tax returns prior to assessment, collection notices, and lost or stolen refunds.<sup>193</sup> In addition, there were 237,885 applications for Taxpayer Assistance Orders, a 250 percent increase over the previous year.<sup>194</sup> The National Taxpayer Advocate attributed this increase, in part, to the provisions of the IRS Reform Act requiring that certain criteria be automatically included in the program as hardship cases.<sup>195</sup> Five cases required an enforced Taxpayer Assistance Order.<sup>196</sup> An enforced Taxpayer Assistance Order is required when the local Taxpayer Advocate and the responsible IRS functional area cannot reach an agreement on case resolution. In 68.8 percent of the Taxpayer Assistance Order cases, the National Taxpayer Advocate was able to provide relief, partial relief, or appropriate assistance to the taxpayer.<sup>197</sup>

The National Taxpayer Advocate reported that taxpayers made more than half a million attempts to reach the Taxpayer Advocate Service during fiscal year 2000 using the dedicated toll-free telephone number, an increase of 90 percent from fiscal year 1999.<sup>198</sup> The Taxpayer Advocate Service answered nearly 300,000 calls, 70 percent more than fiscal year 1999, and resolved more than 19,000 inquiries through the telephone calls.<sup>199</sup>

According to the National Taxpayer Advocate report, the National Taxpayer Advocate developed criteria for the referral of cases to the Taxpayer Advocate Service, implemented new case service quality measurement standards, and implemented a new balanced measurement system relating to customer satisfaction, employee satisfaction, and business results.<sup>200</sup> In

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<sup>191</sup> *Id.*

<sup>192</sup> *Id.* at 133.

<sup>193</sup> *Id.* at 135.

<sup>194</sup> *Id.* at 133.

<sup>195</sup> *Id.*

<sup>196</sup> The enforced Taxpayer Assistance Orders involved innocent spouse relief, a request for a lien withdrawal, a penalty abatement, and two lien subordinations. *Id.* at 134.

<sup>197</sup> *Id.* at 133.

<sup>198</sup> *Id.* at 139. An attempt occurs each time the telephone number is dialed.

<sup>199</sup> *Id.*

<sup>200</sup> *Id.* at 131.

response to a request for more delegated authority to the Taxpayer Advocate Service, the IRS now permits the Taxpayer Advocate Service to take the same actions as IRS Customer Service Representatives in cases that qualify for review by the Taxpayer Advocate Service, including adjustments and other account-related interactions between the IRS and taxpayers.<sup>201</sup> This new authority supplements the statutory authority of the National Taxpayer Advocate and is expected to reduce the number of cases that require referral to other parts of the IRS.<sup>202</sup>

### **C. Taxpayer Rights**

#### **In general**

The IRS Reform Act created or modified numerous taxpayer rights and procedural protections. Most of its provisions were effective either on the date of enactment or within six months after enactment. Thus, the IRS was required to provide guidance to the public and training to its almost 100,000 employees in a very short time frame. The provisions of the IRS Reform Act continue to have a significant impact on the operation of the IRS, and the Commissioner has stated that it will be several years before the changes made by the IRS Reform Act operate at the desired level of efficiency and quality.<sup>203</sup> The IRS views its immediate challenges as training and management.<sup>204</sup>

The Tax Division of the Department of Justice stated that it has experienced a significant decline in referrals of collection-related civil cases from the IRS since enactment of the IRS Reform Act, while the United States Tax Court stated that it has seen no significant change in its caseload as a result of the IRS Reform Act.<sup>205</sup>

Discussed below are several areas that illustrate the difficulties encountered by the IRS in implementing the IRS Reform Act, including: collection due process, innocent spouse relief, offers in compromise, and other collection issues.

#### **Collection due process**

Collection enforcement by the IRS generally takes three forms: (1) placing a lien on a taxpayer's property; (2) placing a levy on the taxpayer's wages or bank account; and (3) seizing

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<sup>201</sup> Internal Revenue Service, *IRS Expands Authority for Taxpayer Advocate Service*, IR-2001-12 (Jan. 24, 2001).

<sup>202</sup> *Id.*

<sup>203</sup> See Treasury Inspector General for Tax Administration, *Semiannual Report to the Congress: April 1, 2000 through September 30, 2000*, Publication 3372 (November 2000), 4 (hereinafter "TIGTA Semiannual Report"); Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Committee on Finance (February 2, 2000), 5.

<sup>204</sup> *Id.*

<sup>205</sup> DOJ Letter; letter from the Honorable Thomas B. Wells, Chief Judge, United States Tax Court, to Lindy L. Paull, Chief of Staff, Joint Committee on Taxation (April 3, 2001).

the taxpayer's business or personal assets. The IRS Reform Act added several due process provisions that increased taxpayer rights during the collection process, such as pre-lien and pre-levy hearings and judicial review of such hearings. In particular, the IRS is required to provide the taxpayer with written notification of the right to an impartial hearing before an appeals officer after a notice of lien has been filed or before a notice of levy is sent.<sup>206</sup> The taxpayer has 30 days to request an appeal, and during this period, the levy or seizure may not take place. In addition, if the taxpayer requests an appeal, the levy or seizure may not take place until the appeals officer makes a finding. Finally, the taxpayer has 30 days to challenge an appeals finding in the U.S. Tax Court or U.S. District Court during which time the IRS may not levy or seize.

The IRS Reform Act also instituted other procedural safeguards. For example, with respect to seizures of assets owned by an individual and used in the course of a business, approval by the district director is required and an analysis must be conducted to show that the taxpayer's other assets are insufficient to satisfy the liability. Seizure of a principal residence requires court approval.

The IRS stated that these provisions have created additional staffing needs at Automated Collection System sites.<sup>207</sup> Prior to the IRS Reform Act, the Automated Collection System sites automatically processed levy actions with minimal staff intervention. As a result of the new due process provisions, the IRS can only initiate a lien or levy action after individually reviewing the facts and circumstances of each case. In addition, Automated Collection System staff is required to prepare cases for referral to Appeals upon receipt of due process hearing requests.<sup>208</sup> Automated Collection System staff that previously had been assigned to processing collection cases has been reassigned to handle the processing of collection due process requests.<sup>209</sup>

The IRS stated that the principal difficulty in carrying out the taxpayer due process provisions of the IRS Reform Act has been engineering an efficient collection due process system that does not disproportionately expend resources on cases in which taxpayers are abusing the process to delay collection.<sup>210</sup> According to the IRS, the inventory of collection due process contains a significant percentage of cases advancing arguments that are frivolous or otherwise without merit.<sup>211</sup> In addition to developing administrative steps to address such

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<sup>206</sup> Secs. 6320 and 6330.

<sup>207</sup> IRS Letter at 88.

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

<sup>210</sup> *Id.* at 90.

<sup>211</sup> *Id.* Practitioners themselves have acknowledged that some taxpayers have requested due process hearings for the sole purpose of delaying the collection process. ABA Letter.

tactics, the IRS stated that it anticipates recommending legislative solutions to the Joint Committee on Taxation and other appropriate Congressional committees in the near future.<sup>212</sup>

In an effort to more efficiently process collection due process cases, the IRS assembled a team to implement collection due process recommendations made by an executive level task force, including:

- establishment of a due process program review in Appeals;
- development of a best practices and case management guide for managers;
- creation of a standardized Appeals referral form to clearly identify the issues being raised by the taxpayer and to assist Appeals in analyzing workload;
- establishment of special purpose aids and an internal collection due process web site to provide quick reference materials;
- development of abbreviated Appeals case memoranda to streamline the hearing process in situations where the taxpayer and the IRS have reached agreement;
- establishment of a procedure that provides time for the collecting office to work with the taxpayer after a hearing request has been made;
- establishment of an inventory tracking system to assist in assessing and predicting the collection due process workload;
- review of lien filing and systematically proposed levy notice criteria; and
- development of a test where employees familiar with Automated Collection System processing are assigned to Appeals to assist in due process hearing requests.<sup>213</sup>

When the due process provisions went into effect in January 1999, Appeals had approximately 60 settlement officers trained to handle collection issues.<sup>214</sup> The IRS stated that Appeals now has 229 personnel (including 67 settlement officers) to handle collection due process cases and is increasing the number of trained employees to 482 in fiscal year 2001.<sup>215</sup> By the end of fiscal year 2001, Appeals will have applied 180 full-time equivalents to close 8,175 collection due process cases.<sup>216</sup> The IRS anticipates that it will apply 75 full-time equivalents to close approximately 4,600 collection due process cases by the first quarter of fiscal year 2002, as indicated by Table 1, below.<sup>217</sup>

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<sup>212</sup> IRS Letter at 91.

<sup>213</sup> *Id.* at 88-89.

<sup>214</sup> *Id.* at 89.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

**Table 1.--Collection Due Process Staffing Levels**

|   | <b>1999<br/>Full-Time<br/>Equivalents</b> | <b>2000<br/>Full-Time<br/>Equivalents</b> | <b>2001<br/>Full-Time<br/>Equivalents<br/>(projected)</b> | <b>1st Quarter 2002<br/>Full-Time<br/>Equivalents<br/>(projected)</b> |
|---|---|---|---|---|
| <b>Collection due process inventory</b> | 4,808                                     | 6,602                                     | 13,296  | 13,105  |
| <b>Cases closed</b>                     | n/a                                       | n/a                                       | 8,175   | 4,600   |
| <b>Full-time equivalents applied</b>    | n/a                                       | n/a                                       | 180   | 75  |
| <b>Employees Trained</b>                | 60  | 67  | 482   | 482   |

Source: Internal Revenue Service

The IRS stated that the due process provisions added by the IRS Reform Act have slowed and lengthened the overall compliance cycle.<sup>218</sup> The IRS attributes this effect to statutory waiting periods and the requirement that no collection action be taken prior to the exhaustion of the taxpayer's judicial due process rights.<sup>219</sup> For example, the IRS estimated that it takes almost one year from the issuance of a collection due process notice in an employment tax case for the IRS to resume collection after the taxpayer has fully exhausted all due process rights.<sup>220</sup> The IRS estimated that other types of cases take at least two-thirds of a year to process.<sup>221</sup> These estimates assume that the case is efficiently moving through the process, with the IRS and the taxpayer attempting to resolve the liability in good faith and without any delays attributable to a backlog.<sup>222</sup>

To protect taxpayer due process rights under the IRS Reform Act, the IRS stated that it has redesigned its collection systems to identify cases in which collection is prohibited.<sup>223</sup> The

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<sup>218</sup> *Id.* Tax practitioner comments received by the Joint Committee staff indicate general taxpayer satisfaction with the collection due process system after enactment of the IRS Reform Act. These comments have noted that the receipt of a collection due process notice has had the positive effect of getting the attention of the taxpayer, thus leading to offers in compromise and installment agreements in many cases. ABA Letter.

<sup>219</sup> IRS Letter at 91.

<sup>220</sup> *Id.*

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *Id.* at 91.

IRS also has provided tax law and procedural training to Appeals and Collections officers, and has taken steps to ensure that taxpayers are fully informed of their rights.<sup>224</sup>

According to the Treasury Inspector General for Tax Administration, the IRS has recently improved its compliance with many of the provisions of the IRS Reform Act relating to collection due process.<sup>225</sup> During the period covered by the Treasury Inspector General's semiannual report, the IRS complied with the specific statutory provisions and its own guidelines in all reviewed seizure cases.<sup>226</sup> In addition, the IRS complied with the IRS Reform Act provisions for all district office levies issued, and for 99 percent of the reviewed Automated Collection System call site levies.<sup>227</sup> However, the semiannual report also noted that the IRS has not yet fully complied with IRS Reform Act provisions requiring the IRS to provide proper and timely notice that a Federal tax lien has been filed.<sup>228</sup>

### **Innocent spouse relief**

Persons filing a joint return are jointly and severally liable for the joint return. Thus, one spouse may be subject to joint liability for the omissions from income or erroneous deductions of the other spouse.

The Code provides conditional relief to an innocent spouse.<sup>229</sup> The IRS Reform Act generally made innocent spouse relief easier to obtain. It eliminated all of the understatement thresholds and requires that the understatement be attributable to an erroneous (rather than grossly erroneous) item of the other spouse. It also allows for apportionment of relief for the taxpayer spouse who simply did not know the extent of the understatement. A taxpayer who is no longer married to, is legally separated from, or has been living apart for at least 12 months from the person with whom the taxpayer originally filed the joint return can elect to limit liability to the portion of the deficiency properly allocable to that individual if he or she did not know, or had no reason to know, of an understatement on a joint return which he or she filed. The election for relief from liability for all joint filers and the separate liability election must be made no later than two years after the date the IRS has begun collection activities for the individual making the election. In addition, the IRS Reform Act gave the IRS the ability to grant equitable relief if (1) relief is otherwise unavailable and (2) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency.<sup>230</sup>

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<sup>224</sup> *Id.* at 90-91.

<sup>225</sup> *See* TIGTA Semiannual Report at 5.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> Sec. 6015.

<sup>230</sup> Sec. 6015(f)

Since passage of the IRS Reform Act, the IRS has faced several difficulties in implementing the innocent spouse provisions. Initially, the IRS had no employees trained in applying the new provisions and no training materials available for the new provisions. In particular, the IRS had no familiarity with applying the equitable relief provision.<sup>231</sup> Thus, the IRS had to train its staff in how to handle these cases. In addition, the IRS did not anticipate the high volume of requests that would be submitted.<sup>232</sup> The IRS also did not have a reliable management information system to track innocent spouse cases.<sup>233</sup> The combination of these factors has resulted in a significant backlog of cases.

In addition, some taxpayers and their representatives have apparently experienced difficulty in ensuring adequate consideration by the IRS of all of the facts relating to individual claims, particularly when the claim involves a low-income taxpayer who is not represented by counsel and the IRS solely relies upon correspondence to process the claim.<sup>234</sup>

To effectively manage the rapidly increasing volume of pending claims for innocent spouse relief, the IRS has taken several steps, including: (1) centralizing management of the program under a senior manager; (2) developing specific flow charts and other training and job aids for the employees doing the screening; (3) revising procedures and training based on initial experience; and (4) instituting a 100-percent review of completed claims to ensure quality and consistency. The IRS also has developed additional computer support.<sup>235</sup>

In the four months preceding the passage of the IRS Reform Act, the IRS received 3,000 claims for innocent spouse relief.<sup>236</sup> As of March 6, 2001, the IRS had 40,278 pending claims (affecting 21,198 taxpayers) with regard to which the IRS had not yet notified the taxpayer of a determination.<sup>237</sup> In fiscal year 2000, the number of claims received by the IRS increased 22 percent, and the IRS processed a total of 42,546 innocent spouse claims.<sup>238</sup> Of the 111,243

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<sup>231</sup> Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Finance Committee (February 2, 2000), at 7.

<sup>232</sup> Attorneys may have begun adopting a standard practice of submitting claims for innocent spouse relief in divorce proceedings as a matter of course, and regardless of the merits of the claim, in order to avoid potential to malpractice lawsuits. NAEA Letter.

<sup>233</sup> Statement of the Honorable David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, before the Senate Committee on Finance (February 2, 2000), at 3.

<sup>234</sup> ABA Letter.

<sup>235</sup> Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Senate Finance Committee (February 2, 2000), at 7.

<sup>236</sup> *Id.* at 6.

<sup>237</sup> IRS Letter at 102.

<sup>238</sup> *Id.*

claims (affecting 58,549 taxpayers) received by the IRS since passage of the IRS Reform Act, the IRS had not yet notified 21,136 taxpayers of its determination by the end of fiscal year 2000.<sup>239</sup> The IRS anticipates that it will close 57,659 innocent spouse claims during fiscal year 2001.<sup>240</sup>

Based upon innocent spouse claims where the IRS has notified the taxpayer of a determination, the average processing time for claims (from initial receipt of a claim to delivery of a determination letter to the taxpayer) is shown in Table 2, below.<sup>241</sup>

**Table 2.--Average Number of Days to Process Innocent Spouse Claims**

|   | <b>Average Number of Days<br/>(All Innocent Spouse Claims)</b> | <b>Average Number of Days<br/>(Claims Filed in FY 2000)</b> |
|---|--|---|
| <b>Non-Qualifying Claims</b>                            | 142  | 80  |
| <b>Claims Not Meeting Basic<br/>Filing Requirements</b> | 128  | 81  |
| <b>Meritorious Claims</b>                               | 318  | 238   |

Source: Internal Revenue Service

The IRS noted that the average processing time for innocent spouse claims varies among individual field areas and from field areas to the centralized processing site.<sup>242</sup> The number of days that the IRS calculated for processing innocent spouse claims took into account required waiting periods to receive information and communicate with taxpayers, some of which are mandated by statute.<sup>243</sup> For example, before the IRS can make a determination, there is a required 45-day waiting period to contact and wait for a response from the non-requesting spouse. In addition, following notification to the taxpayer of a determination, there is a 30-day opportunity for the taxpayer to request an administrative appeal and a 90-day period for the taxpayer to petition the Tax Court. Some of these time periods may decrease as a result of a technical correction made to section 6015(e) in 2000 that may eliminate part of the processing time by allowing the IRS to secure taxpayer waivers of the mandated time periods.<sup>244</sup>

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<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.* at 102-103.

<sup>242</sup> *Id.* 102.

<sup>243</sup> *Id.*

<sup>244</sup> Pub. L. No. 106-554 (2000).

In order to decrease the backlog of pending innocent spouse claims and to reduce the average processing time for claims, the IRS has stated that it is taking the following steps:

- By May 2001, the IRS expects to have increased the staffing at the centralized processing site by 50 positions, an increase of over 46 percent from the 107 employees in fiscal year 2000. Thirty of the new positions are temporary in nature, created to deal specifically with the current backlog of inventory. The IRS also upgraded the tax examiner position, thereby increasing the number of examiners who make determinations on more complex claims.
- In January 2001, the IRS developed and implemented an Integrated Case Processing software application in the centralized processing site. This software application will lead the examiner through the complex decision-making process and create a paper trail to document the decision. Additional phases of software will include the account research and screening phases of the process.
- In January 2001, the IRS implemented a new automated Master File account used for recording and maintaining information relating to separate spousal account transactions. It replaces the manual Automated Non-Master File system.
- Early in fiscal year 2001, the IRS temporarily assigned appeals officers to 120-day assignments in local field quality review sites to assist with backlogs in the field.<sup>245</sup>

With the staffing increases that have already occurred and the implementation of the Integrated Case Processing software application, the IRS has indicated that it will have sufficient staff to process claims for innocent spouse relief within acceptable time periods.<sup>246</sup>

A taxpayer requesting innocent spouse relief under sec. 6015(b) (relating to relief for understatements of tax on certain joint returns) has the burden of showing that he or she “did not know, and had no reason to know,” of the understatement. By contrast, when a taxpayer who is no longer married or has legally separated elects the allocation of tax liability for a joint return under sec. 6015(c), the IRS has the burden of demonstrating that the taxpayer did not have “actual knowledge” of any item giving rise to the understatement. The National Taxpayer Advocate has identified these differing knowledge standards under sec. 6015 as a problem area. In particular, a review of innocent spouse claims determined that IRS examiners were having difficulty applying these standards, and that knowledge of understatements was the primary reason for denial of innocent spouse claims.<sup>247</sup> The IRS also found that examiners were having difficulty applying the requirement under the sec. 6015(f) equitable relief provisions that the taxpayer must have a “reasonable belief that the tax would be paid.”<sup>248</sup>

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<sup>245</sup> IRS Letter at 103.

<sup>246</sup> *Id.* at 104.

<sup>247</sup> *Id.*

<sup>248</sup> *Id.* The Tax Section of the American Bar Association noted that the experience of some tax practitioners is that some IRS personnel may be reluctant to grant requests for equitable relief under sec. 6015(f) and appear to be placing a heavy burden on taxpayers to show that they did not have knowledge or reason to know of an underpayment of tax. ABA Letter.

In May 2000, the IRS identified a need for additional training in applying these knowledge standards and, in March 2001, the IRS developed and delivered training in this area.<sup>249</sup> Because of the difficulties in applying the sec. 6015(c) actual knowledge standard, the IRS stated in its April 27, 2001 letter to the Joint Committee staff that it supports removal of the sec. 6015(c) knowledge standard, while acknowledging that removing this knowledge standard could increase the number of claims for innocent spouse relief.<sup>250</sup>

Recently, courts have issued several decisions interpreting the actual knowledge standard of sec. 6015(c). These decisions may lessen some of the uncertainty that the IRS has faced in interpreting this knowledge standard.

### **Offers in compromise**

Prior to the IRS Reform Act, the IRS could settle a tax liability for less than the amount assessed through an offer in compromise, but the IRS only would accept an offer in compromise if there was sufficient doubt as to the existence or amount of the tax liability or if there was doubt as to the ability of the taxpayer to pay the tax due. The IRS Reform Act codified the offer in compromise program with the intent that the program should be expanded to cover cases in which considerations of equity, economic hardship, and public policy favor accepting an offer in furtherance of effective tax administration.<sup>251</sup>

With regard to the length of time to process an offer in compromise, the IRS stated that it completed the processing of 38 percent of the offers in compromise received in fiscal year 2000 within six months of submission of an offer, and completed the processing of 45 percent of the remaining offers by the end of the year.<sup>252</sup> Through January 2001, the IRS resolved 32 percent of the offers submitted within the first six months.<sup>253</sup>

The IRS attributed the delay in processing offers in compromise to several factors, including: mandated administrative review of IRS decisions to reject offers or return offers for failure to provide financial information; expansion of the offer in compromise program to cases that would promote effective tax administration; not automatically rejecting incomplete offers; and no longer accepting installment agreements that would not satisfy the entire tax liability (thus increasing the number of offers involving cases that might otherwise be resolved through

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<sup>249</sup> IRS Letter at 104.

<sup>250</sup> *Id.* at 104-105. As of March 6, 2001, the IRS received and decided only 4,725 innocent spouse claims under sec. 6015(c) (or 11 percent of the 42,324 meritorious innocent spouse claims that the IRS decided in total as of that date). *Id.* at 104.

<sup>251</sup> Sec. 7122(c) and (d).

<sup>252</sup> IRS Letter at 99.

<sup>253</sup> *Id.* Some practitioners have apparently complained about the inordinate amount of time required by the IRS to process offers in compromise, stating that the IRS usually takes at least a year to complete the initial review process. ABA Letter.

installment agreements).<sup>254</sup> The IRS stated that it could more efficiently evaluate and process offers in compromise through future automation.<sup>255</sup>

The IRS stated that it has made efforts to reduce the amount of time for processing offers in compromise by increasing the number of assigned staff through a realignment of field resources.<sup>256</sup> In fiscal year 2000, the IRS increased assigned revenue officers, paraprofessionals, and clerical staff from 762 to 1,230 full-time equivalents and will further increase the staffing to 1,267 by the end of fiscal year 2001.<sup>257</sup> The IRS stated that it also will provide additional recommendations to reform the process for offers in compromise.<sup>258</sup>

The IRS stated that it is reviewing and reengineering its work processes to address the growing number of offer in compromise cases.<sup>259</sup> In an effort to improve efficiency and reduce the backlog in the inventory of offer in compromise cases, the IRS is centralizing cases that may be most effectively processed in a service center environment.<sup>260</sup> The IRS stated that it conducted a pilot program in two service centers to test the feasibility of centralized processing of offers with respect to amounts of original tax liability of less than \$50,000.<sup>261</sup> Based upon the results of the pilot program, the IRS expects that centralized bulk processing of offers in compromise will produce efficiency gains in staffing and reduce the amount of time to process offers.<sup>262</sup> Beginning in July 2001, all new offers in compromise will be sent to one of two service centers, depending upon where the taxpayers resides.<sup>263</sup> Table 3, below, shows the

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<sup>254</sup> IRS Letter at 100. The determination that the IRS may not enter into an installment agreement with a taxpayer unless the full amount of tax due will be paid is based upon an IRS legal interpretation of the interplay between sec. 6159 (installment agreements) and sec. 7122 (offers in compromise). According to IRS Chief Counsel, a taxpayer may resolve a tax liability for less than the full amount of the tax due only through the sec. 7122 offer in compromise procedure. *Id.* at 95.

<sup>255</sup> *Id.* at 100-101.

<sup>256</sup> *Id.* at 99.

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* at 92.

<sup>260</sup> *Id.*

<sup>261</sup> *Id.* at 99.

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

expected staffing impact of centralized processing of offers in compromise, based upon the projected increase in offers.<sup>264</sup>

**Table 3.--Expected Impact of Centralized Processing of Offers in Compromise**

|                            | <b>Expected Receipts</b> | <b>Field Closures</b> | <b>Svc. Center Closures</b> | <b>Field Full-Time Equivalents</b> | <b>Svc. Center Full-Time Equivalents</b> | <b>Total Full-Time Equivalents</b> |
|----------------------------|--------------------------|-----------------------|-----------------------------|------------------------------------|--|------------------------------------|
| <b>FY 2000 (actual)</b>    | 109,296                  | 84,391                | -                           | 1,230                              | -  | 1,230                              |
| <b>FY 2001 (projected)</b> | 129,230                  | 87,000                | -                           | 1,267                              | -  | 1,267                              |
| <b>FY 2002 (estimated)</b> | 144,252                  | 84,806                | 73,568                      | 1,236                              | 938                                      | 2,174                              |
| <b>FY 2003 (estimated)</b> | 161,020                  | 84,806                | 91,920                      | 1,236                              | 1,126                                    | 2,362                              |
| <b>FY 2004 (estimated)</b> | 179,736                  | 84,806                | 101,466                     | 1,236                              | 1,243                                    | 2,479                              |

Source: Internal Revenue Service

As discussed above, the IRS Reform Act expanded the offer in compromise program to cases in which settlement would promote effective tax administration. However, the IRS stated that fewer than 1 percent of total offers in compromise for fiscal year 2000 through February 2001 were initiated on the basis of the additional factors specified in the IRS Reform Act, including situations involving severe or unusual economic hardship.<sup>265</sup> In fiscal year 2000, the IRS stated that it received only 580 such offers out of a total of 47,554 offers.<sup>266</sup> The IRS accepted approximately 88 percent of these offers, while the remaining 12 percent were either rejected by the IRS or withdrawn by the taxpayer.<sup>267</sup>

However, tax practitioner comments indicate that, while there has been a noticeable increase in the use of offers in compromise by taxpayers, there has not been a corresponding increase in IRS acceptance of offers in compromise.<sup>268</sup> These comments further indicate that IRS personnel reviewing offers in compromise often question the existence of economic hardship and “rarely, if ever,” determine that equitable factors are present that would merit

<sup>264</sup> *Id.* at 92.

<sup>265</sup> *Id.* at 100.

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

<sup>268</sup> ABA Letter.

accepting an offer.<sup>269</sup> In many cases, IRS personnel still may be reviewing offers in compromise solely on the basis of doubtful liability or collectibility without considering the additional factors mandated by the IRS Reform Act (*e.g.*, equity, hardship, and public policy).<sup>270</sup>

### **Other collection issues**

From fiscal year 1996 to fiscal year 1999, the Treasury Inspector General for Tax Administration stated that revenue collected as a result of compliance activity decreased by \$5 billion and gross accounts receivable increased by \$41 billion, leading to concern about the amount of resources being allocated to collection activities and the related decrease in business results.<sup>271</sup> Decreased enforcement also has been attributed to concerns of IRS employees over the mandatory termination provisions added by the IRS Reform Act.<sup>272</sup>

In comparison with fiscal year 2000 results, the IRS stated that it is experiencing both positive and negative trends in collection activity during fiscal year 2001.<sup>273</sup> The IRS noted that enforcement actions are increasing in fiscal year 2001, with positive trends in the number of liens filed and levies issued by the IRS.<sup>274</sup> According to the IRS, both delinquent notice yield and Taxpayer Delinquent Account dollars collected have increased through February 2001.<sup>275</sup> However, certain other collection measurements have slightly decreased in fiscal year 2001 due to the need to redirect resources to handle the increase in the numbers of offers in compromise and collection due process cases.<sup>276</sup>

The IRS stated that the amount of time between the filing of a return and the first compliance contact has remained constant at six to eight weeks over the years.<sup>277</sup> If the taxpayer does not pay the deficiency after the first contact, the IRS issues four additional notices over the next 42 weeks prior to assignment for collection.<sup>278</sup> However, high-risk accounts are assigned

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<sup>269</sup> *Id.* Some practitioners apparently believe that the temporary regulations under sec. 7122 are being too narrowly construed because they contain examples that place undue emphasis on medical disability in determining whether collection of the full tax liability would result in economic hardship. *Id.*

<sup>270</sup> *Id.*

<sup>271</sup> *See* TIGTA Semiannual Report at 4.

<sup>272</sup> *Id.*

<sup>273</sup> IRS Letter at 94.

<sup>274</sup> *Id.*

<sup>275</sup> *Id.*

<sup>276</sup> *Id.* at 94-95.

<sup>277</sup> *Id.* at 95.

<sup>278</sup> *Id.*

for collection approximately six weeks after the first contact.<sup>279</sup> High-risk cases represent about 20 percent of the collection cases.<sup>280</sup> In 2000, the IRS stated that the average assignment for collection required 33 weeks to resolve, while the fiscal year 2001 plan projects this amount of time to be reduced to 26 weeks.<sup>281</sup>

Since its last hiring initiative in fiscal year 1995, the IRS has experienced a steady decline in the number of field collection staff available to collect delinquent taxes and to secure delinquent tax returns.<sup>282</sup> The IRS stated that it plans to hire 470 Revenue Officers in fiscal year 2001, which will stabilize the workforce and allow the IRS to allocate resources to areas of concentrated workload.<sup>283</sup> Table 4, below, shows the fiscal year 2000-2001 staffing levels for collection activities in Service Center and Field Collection operations, as well as the projected staffing levels for fiscal year 2002.<sup>284</sup>

**Table 4. Service Center, Field Collection, and Revenue Officer Staffing Levels**

|                                     | <b>FY 2000<br/>Full-Time<br/>Equivalents</b> | <b>FY 2001<br/>Full-Time<br/>Equivalents</b> | <b>FY 2002<br/>Full-Time<br/>Equivalents<br/>(projected)</b> |
|-------------------------------------|--|--|--|
| <b>Service Center Collection</b>    | 2,501  | 2,634  | 2,662  |
| <b>Field Collection<sup>1</sup></b> | 9,254  | 9,016  | 9,486  |
| <b>Revenue Officers<sup>2</sup></b> | 6,195  | 6,089  | 6,559  |
| <b>Less: Filing Season Support</b>  | (683)  | (376)  | (189)  |
| <b>Revenue Officers (Net)</b>       | 5,512  | 5,713  | 6,370  |

Source: Internal Revenue Service

<sup>1</sup> Includes all GS-1169 series revenue officers, managers, clerical, and paraprofessional employees in the field.

<sup>2</sup> Includes only GS-1169 series revenue officers and managers (frontline field, technical, and insolvency personnel).

The Revenue Officer category is a subset of the Field Collection category.

In addition to increasing Revenue Officer staffing levels, the IRS is decreasing the amount of Revenue Officer time applied to filing season activities.<sup>285</sup> In fiscal year 2000,

<sup>279</sup> *Id.*

<sup>280</sup> *Id.*

<sup>281</sup> *Id.*

<sup>282</sup> *Id.* at 91.

<sup>283</sup> *Id.*

<sup>284</sup> *Id.* at 92.

<sup>285</sup> *Id.* at 91.

compliance programs overall contributed 1,933 full-time equivalents to filing season programs that included Toll-Free Assistance, Walk-In Assistance, and Outreach Efforts (e.g., taxpayer education, Volunteer Income Tax Assistance, and Tax Counseling for the Elderly).<sup>286</sup> The IRS stated that a key objective of the fiscal year 2001/2002 Staffing Tax Administration for Balance and Equity budget initiative is to reduce the reliance on compliance and enforcement staff for taxpayer assistance.<sup>287</sup>

In fiscal year 2001, the IRS expects to divert 40 percent fewer full-time equivalents to assistance programs.<sup>288</sup> A second reduction of nearly 50 percent is expected to occur in fiscal year 2002 and, by fiscal year 2003, the IRS expects that detailees from Examination and Collection will be nearly eliminated.<sup>289</sup> For Revenue Officers in particular, the IRS expects that the number of full-time equivalents detailed to filing season activities will be reduced from 683 in fiscal year 2000 to 376 in fiscal year 2001 and to 189 in fiscal year 2002.<sup>290</sup> These Revenue Officer full-time equivalents will be redirected to collection activities.<sup>291</sup> The table above shows available Revenue Officer full-time equivalents after considering the impact of temporary assignments for filing season support.<sup>292</sup>

As indicated, the IRS has attributed the overall decline in collection and compliance efforts in recent years to a decrease in staffing levels, the diversion of resources to customer service, an increase in employee training, and an increase in the amount of time needed to resolve cases. In addition to the steps already discussed, the IRS stated that it is taking several measures to increase the resources applied to collection and compliance activities.

First, the IRS stated that it would focus enforcement activities on areas most in need of attention through the IRS Strategic Planning and Budgeting process.<sup>293</sup> For example, the National Nonfiler Strategy is a coordinated effort to bring nonfilers back into the system and keep them in the system, using information from State and private sector data sources to identify the most significant areas of noncompliance and determine the causes of noncompliance.<sup>294</sup> This program also will involve education, outreach, and alternative treatment programs to address

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<sup>286</sup> *Id.*

<sup>287</sup> *Id.*

<sup>288</sup> *Id.*

<sup>289</sup> *Id.*

<sup>290</sup> *Id.* at 92.

<sup>291</sup> *Id.*

<sup>292</sup> *Id.*

<sup>293</sup> *Id.* at 93.

<sup>294</sup> *Id.*

noncompliance of certain taxpayer groups.<sup>295</sup> The IRS also is developing a strategy to reduce accounts receivable.<sup>296</sup>

In addition, the IRS stated that it would undertake several efforts to reengineer and realign work processes to improve the effectiveness of compliance activities.<sup>297</sup> Among other things, this project will involve the use of certain scoring techniques to identify and assign cases that have the greatest impact on noncompliance.<sup>298</sup> The IRS also will centralize and consolidate the support services associated with case processing, workload delivery, and technical support.<sup>299</sup> The IRS expects that this will result in efficiencies and the potential for reassigning enforcement personnel to frontline activities.<sup>300</sup>

Finally, the IRS stated that it would ensure a more constant and stable workforce with a new recruiting and hiring program.<sup>301</sup> The IRS expects that this program will serve to continually replenish its workforce and allow the placement of employees in areas of concentrated workload.<sup>302</sup>

#### **D. Treasury Inspector General For Tax Administration**

##### **In general**

The IRS Reform Act created the Office of Treasury Inspector General for Tax Administration. The Treasury Inspector General for Tax Administration conducts audits, investigations, and evaluations of IRS programs and operations (including the IRS Oversight Board).<sup>303</sup> In addition, on an ongoing basis, the Treasury Inspector General for Tax Administration evaluates the adequacy and security of IRS technology. The Treasury Inspector General for Tax Administration also investigates criminal and administrative misconduct, such as violations of the Taxpayer Bill of Rights and ethical violations. Taxpayers may report allegations of IRS misconduct by a toll-free number maintained by the Treasury Inspector General for Tax Administration. Part of the Treasury Inspector General for Tax Administration's responsibility includes protecting the IRS from external threats to corrupt or

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<sup>295</sup> *Id.*

<sup>296</sup> *Id.*

<sup>297</sup> *Id.* at 93-94.

<sup>298</sup> *Id.* at 94.

<sup>299</sup> *Id.*

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> *Id.*

<sup>303</sup> Treasury Order 115-01(b) (January 14, 1999).

harm employees. The Treasury Inspector General for Tax Administration conducts periodic audits of at least one percent of all determinations in which the IRS has asserted the confidentiality provisions (either alone or in conjunction with the Freedom of Information Act or Privacy Act), or law enforcement considerations as the basis for denying requested information.<sup>304</sup>

### **Semiannual report**

The Treasury Inspector General for Tax Administration's semiannual report to the Congress for the period April 1, 2000, through September 30, 2000, reports that the Treasury Inspector General for Tax Administration issued 162 audit reports during fiscal year 2000, more than double the number for fiscal year 1999. Financial results due to audit reports totaled \$117.1 million and an additional \$1.4 billion in increased revenue and protected revenue. The Treasury Inspector General for Tax Administration estimates that its audit recommendations will improve tax administration for approximately 11.4 million taxpayers. In addition, the Treasury Inspector General for Tax Administration closed nearly 4,200 investigations of criminal wrongdoing and administrative misconduct during fiscal year 2000, a 43 percent increase over fiscal year 1999. Investigations recovered \$12.9 million.<sup>305</sup>

The following discussion highlights some of the material contained in the Treasury Inspector General for Tax Administration's semiannual report.

#### **IRS implementation of the IRS Reform Act**

According to the Treasury Inspector General for Tax Administration, many of the IRS Reform Act provisions, including training programs for thousands of IRS employees, have been implemented, which is a good improvement over prior years. For example, the the Treasury Inspector General for Tax Administration's Office of Audit reported that IRS was in compliance for all seizure cases reviewed, all district office levies issues, and for 99 percent of the Customer Service Automated Collections System call site levies reviewed. However, the IRS was not yet in full compliance on restricting the use of enforcement statistics to evaluate IRS employees, not designating taxpayers as illegal tax protesters, providing proper and timely notice that a federal tax lien has been filed, and not withholding information in response to taxpayers' written requests for information under the Freedom of Information Act of 1988 or the Privacy Act of 1974.<sup>306</sup>

#### **Providing security over information systems**

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<sup>304</sup> Sec. 7803(d)(3)(A).

<sup>305</sup> Letter from David C. Williams, Inspector General, to the Honorable Lawrence H. Summers, Secretary of the Treasury (October 30, 2000) (enclosing the Treasury Inspector General for Tax Administration's Semiannual Report).

<sup>306</sup> TIGTA Semiannual Report at 5.

The Treasury Inspector General for Tax Administration reports that the IRS has conducted comprehensive security reviews of its major facilities and significantly reduced previously identified computer security problems. Nevertheless, despite such progress, more improvements are needed. Weaknesses in key programs include security certification and accreditation of sensitive systems, virus protection, and mainframe operating system controls. For example, the Treasury Inspector General for Tax Administration reports that of 258 sensitive computer systems, 232 have not been certified as required by the Office of Management and Budget and Treasury.<sup>307</sup> Until such weaknesses are resolved, IRS systems and taxpayer data remain vulnerable to tampering, loss, or unauthorized disclosure.<sup>308</sup>

#### Protecting revenue and minimizing tax fraud

The earned income credit continues to be a high-risk area for filing fraud. The Treasury Inspector General for Tax Administration reports that the IRS' weaknesses are primarily: achieving full participation by eligible taxpayers; ensuring compliance through verification of taxpayers' eligibility; and reducing inherent vulnerabilities, for example, multiple use of dependent Social Security numbers.<sup>309</sup>

To protect revenue, the Treasury Inspector General for Tax Administration recommends that the IRS should expand early intervention efforts nationwide further to reduce unreported estate executor commissions, which could result in an additional \$2.6 million in taxes and interest over five years.

#### Providing customer service and ensuring tax compliance

The Treasury Inspector General for Tax Administration reports that the IRS currently does not have a reliable method to measure voluntary compliance by taxpayers or to measure the impact that increased customer service and decreased enforcement are having on voluntary compliance.<sup>310</sup> Unless the IRS strengthens its enforcement capacity, the Treasury Inspector General for Tax Administration concludes that voluntary compliance will be severely eroded.<sup>311</sup>

#### Taxpayer rights

Separate audit reports on protecting taxpayer rights concluded that: significant improvements are needed in processing gift tax payments and associated extensions to file; increased attention is needed to ensure timely, accurate determinations on innocent spouse

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<sup>307</sup> *Id.* at 11.

<sup>308</sup> *Id.* at 3.

<sup>309</sup> *Id.* at 5.

<sup>310</sup> *Id.* at 4.

<sup>311</sup> *Id.*

claims for relief; bankruptcy automatic stay violations need to be better addressed by IRS; and opportunities exist to identify unreported taxes from employers' quarterly federal tax returns.<sup>312</sup>

### Managing Finances

The Treasury Inspector General for Tax Administration Office of Audit reported that the IRS' financial management systems do not comply with the federal financial management systems requirements, federal accounting standards, or the U.S. Government General Ledger. Accordingly, as required by the Federal Financial Management Improvement Act of 1996, the IRS prepared a remediation plan to bring its financial systems into compliance. Although the Treasury Inspector General for Tax Administration found that the remediation plan was reasonable and soundly addressed some of the problems, the plan did not include all reported weaknesses and did not always clearly identify resource commitments. The Treasury Inspector General for Tax Administration recommended that IRS revise the plan to ensure that financial management weaknesses will be resolved adequately and on time. The IRS took further action in satisfaction of the Treasury Inspector General for Tax Administration's requests.

### Criminal and misconduct investigations

The Treasury Inspector General for Tax Administration continues to operate, through the Complaint Management Division, a centralized clearinghouse for processing and tracking allegations of fraud, waste, abuse, and other forms of wrongdoing by IRS agents. During the reporting period, the Treasury Inspector General for Tax Administration received 4,763 complaints, of which 2,053 warranted further investigation.<sup>313</sup> Of the total complaints, 257 allegations involved potential violations of section 1203 of the IRS Reform Act.<sup>314</sup> Investigations are opened on section 1203 actions if preliminary analysis reveals a basis for the allegation. During the reporting period, the Treasury Inspector General for Tax Administration initiated 164 section 1203 investigations.<sup>315</sup>

The Strategic Enforcement Division of the Treasury Inspector General for Tax Administration identifies and initiates criminal investigations involving fraud and abuse of IRS computer systems and violations of the Taxpayer Browsing Protection Act of 1997. During the reporting period, the Strategic Enforcement Division analyzed 296 leads of potential unauthorized access to tax information by IRS employees, resulting in 123 referrals to field special agents. The Treasury Inspector General for Tax Administration also completed 372

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<sup>312</sup> *Id.* at 17-19.

<sup>313</sup> *Id.* at 26, 46.

<sup>314</sup> This section provides for mandatory termination of an IRS employee for certain conduct. For more detailed discussion of section 1203 actions, *see* Part IV.C.

<sup>315</sup> TIGTA Semiannual Report at 26.

investigations related to threats, assaults, or harassment of IRS employees as they carry out their duties.<sup>316</sup>

### Audit reports with unimplemented corrective actions

The Treasury Inspector General for Tax Administration reports that there are about 120 significant recommendations for corrective action, contained in 44 audit reports, that remain outstanding.<sup>317</sup> Many of the recommendations pertain to the Treasury Inspector General for Tax Administration's review of the electronic fraud detection system, improvement to IRS computer systems, better compliance with processing requests under the Freedom of Information Act, improvements to the estate tax collection process, and the decline in the level of toll-free telephone service.

## **E. Personnel Flexibility and IRS Management**

### **IRS Reform Act**

The IRS Reform Act gave the IRS considerable authority beyond the personnel rules and procedures found in Title 5 relating to:

- Pay authority for critical positions.--Upon request of the Treasury Secretary, the Office of Management and Budget is authorized to set a basic salary rate for Acritical pay positions@ at levels higher than those generally authorized in the civil service laws for critical positions. These rates, including bonuses, awards and differentials, cannot exceed the rate of pay for the Vice President (currently \$175,000).
- Streamlined critical pay authority.--The Treasury Secretary can designate positions, set pay, and appoint up to 40 individuals to critical administrative, technical and professional positions. Compensation cannot exceed that of the Vice President.
- Recruitment, retention and relocation incentives.--The Treasury Secretary was given the authority to offer incentives for recruitment, retention, and relocation and to pay relocation expenses.
- Performance awards for senior executives.--The Treasury Secretary was also given greater authority to pay performance bonuses to members of the Senior Executive Service.
- New performance management system.--A new performance management system, stressing individual accountability is to be implemented. The IRS Reform Act prohibits the use of enforcement goals, quotas or statistics as the basis for awarding bonuses or merit pay.

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<sup>316</sup> *Id.* at 35.

<sup>317</sup> *Id.* at 49-61.

- Workforce classification and pay.--The Secretary can combine grades and salary ranges to create broad banded systems for any or all of the IRS work force.
- Limited appointments to career reserved Senior Executive Service positions.--The IRS Reform Act permits the IRS to fill certain permanent positions with temporary employees. The IRS Reform Act broadens the definition of a career reserved position to include a limited emergency appointee. It also covers a limited-term appointee who immediately upon entering the career reserved position, served under a career or a career-conditional appointment outside of the Senior Executive Service, or where the Office of Personnel Management approved the limited emergency or limited term appointment in advance.
- Workforce staffing.--Candidates for positions can be selected from the highest quality category regardless of individual numerical rating. Further, the IRS can establish a three year probationary period when a shorter period is insufficient to evaluate an employee. The Secretary may also detail an employee to a different assignment without regard to the 120 day limitation otherwise applicable.
- Streamlined demonstration project authority.--The IRS Reform Act permits the IRS to take a streamlined approach to conducting research and testing alternative management constructs. A demonstration project under this section would not be subject to the ordinarily lengthy approval process.

## **Implementation efforts**

### Recruitment efforts

To attract and retain highly qualified and exceptional individuals, the IRS is using a variety of techniques. First, the IRS uses professional search firms to identify such individuals and initially screen those who may not be interested in public service.<sup>318</sup> Additionally, groups of several executives, often including the Commissioner, Deputy Commissioner, and Treasury officials interview Streamlined Critical Pay candidates. The Commissioner is the final selecting official for all Streamlined Critical Pay executives, with final approval by the Treasury Department.

According to the IRS, the Streamlined Critical Pay executives have brought knowledge and expertise that would not otherwise have been available. For example, currently two of the four Division Commissioners, the National Taxpayer Advocate and the Chief, Criminal Investigation are all external hires with substantial experience.<sup>319</sup> All of the Senior Industry Advisors in the Large and Mid-Size Business Division are from the industries to which they are

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<sup>318</sup> IRS Letter at 35.

<sup>319</sup> *Id.* at 39.

assigned.<sup>320</sup> The Chief, Agencywide Shared Services, was recruited from a major international corporation where he managed the same functions.<sup>321</sup>

Loss of Streamlined Critical Pay executives

From the passage of the IRS Reform Act in July 1998 through April 25, 2001, the IRS has hired 29 Streamlined Critical Pay executives (21 currently working for the IRS).<sup>322</sup> Through April 25, 2001, eight Streamlined Critical Pay executives have left the IRS as shown in Table 5, below. The average tenure of the executives who have left is approximately 17 months, with some staying as few as five months and others as long as 29 months.

**Table 5.--Streamlined Critical Pay Executives Who Have Left the IRS**

| POSITION TITLE  | RATE OF PAY | INCENTIVES/<br>BONUSES  | DATES OF SERVICE    |
|---|-------------|---|---------------------|
| Chief Financial Officer   | \$147,500   | None  | 8/16/98 TO 6/29/99  |
| Director, Program Control Information Systems                                 | \$130,000   | None  | 12/19/99 TO 6/03/00 |
| Assistant Commissioner (Management and Financial Systems) Information Systems | \$135,000   | None  | 5/9/99 TO 8/01/00   |
| Director, Government Program Management Office, Information Systems           | \$160,000   | \$15,000 (Recruitment, 11/2/98)   | 11/2/98 TO 8/01/00  |
| Director, Real Estate and Facilities Management, Agencywide Shared Services   | \$176,300   | \$37,800 (Recruitment, 3/15/00)   | 3/15/00 TO 7/31/00  |
| National Taxpayer Advocate  | \$144,800*  | \$15,000 (Recruitment, 9/1/98)<br>\$25,000 (Annual Performance, 1/18/01)  | 9/1/98 TO 10/10/00  |
| Deputy Commissioner/ Modernization  | \$155,100*  | \$25,000 (Recruitment, 9/6/98)<br>\$20,000 (Annual Performance, 1/18/01)  | 9/6/98 TO 10/08/00  |
| Chief Information Officer   | \$181,400*  | \$43,600 (Recruitment, 8/11/98)<br>\$25,000 (Annual Performance, 1/16/01) | 8/11/98 TO 1/26/01  |

\*Salary at departure. Source: Internal Revenue Service

<sup>320</sup> *Id.*

<sup>321</sup> *Id.*

<sup>322</sup> IRS Letter at 35.

### Other personnel issues

Workforce classification and pay<sup>323</sup>.--On March 25, 2001 the IRS converted the first employees into the Senior Manager Payband established under the IRS Reform Act's workforce classification and pay authority (5 U.S.C. 5909). The new payband covers employees in positions formerly classified at the GS-14 and GS-15 grade levels who are second level managers or first level managers reporting directly to executives. These positions are found in all organizations within the IRS, and they share similar responsibility for meeting the IRS mission. The pay range for these positions will be from the minimum rate for GS-14 to the maximum rate for GS-15. Advancement through the range will be based on biennial salary reviews, considering performance as it is appraised under the new performance management system and the increasing difficulty of the position.

The IRS is developing a strategy to place most other non-bargaining unit positions in paybands. In addition, the IRS is developing paybands for all Information Systems employees, and for criminal investigators (special agents). The IRS hopes get approval to proceed with these new initiatives early in the third quarter of this fiscal year.

Performance management.--The Performance Management System for Executives, Managers, and Management Officials was implemented in fiscal year 2000. For fiscal year 2001, the IRS incorporated leadership competencies into the performance expectations for executives and managers.<sup>324</sup> This was done to facilitate alignment of the evaluations system with the systems for selection and development of organizational leaders.<sup>325</sup>

In addition, the IRS is negotiating with the National Treasury Employees Union over impact and implementation of new Critical Job Elements for employees that are aligned with the IRS Balanced Measurement System.<sup>326</sup> The IRS anticipates implementation of the new Critical Job Elements in summer 2001.

### **F. Violations for Which IRS Employees May Be Terminated**

The IRS Reform Act defined 10 specific acts of misconduct for which an IRS employee may be terminated ("section 1203 violations"). These acts are:

- (1) willful failure to obtain the required approval signatures on documents authorizing a seizure of a taxpayer's home, personal belongings, or business assets;
- (2) providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative;

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<sup>323</sup> See generally IRS Letter at 41.

<sup>324</sup> IRS Letter at 41.

<sup>325</sup> *Id.*

<sup>326</sup> IRS Letter at 41.

- (3) violation of the rights protected under the Constitution or the civil rights established under six specifically identified laws with respect to a taxpayer, taxpayer representative, or other employee of the IRS<sup>327</sup>
- (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;
- (5) assault or battery on a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, but only if there is a criminal conviction, or a final judgment by a court in a civil case, with respect to the assault or battery;
- (6) violations of the Internal Revenue Code of 1986, Department of Treasury regulations, or policies of the Internal Revenue Service (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing, a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service;
- (7) willful misuse of the provisions of section 6103 of the Internal Revenue Code of 1986 for the purpose of concealing information from a congressional inquiry;
- (8) willful failure to file any return of tax required under the Internal Revenue Code of 1986 on or before the date prescribed therefor (including any extensions), unless such failure is due to reasonable cause and not to willful neglect;
- (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect; and
- (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.<sup>328</sup>

In his or her sole discretion, the Commissioner may determine that there are mitigating factors which weigh against terminating an employee. This discretionary authority cannot be delegated.

Each allegation of a section 1203 violation goes through a review and investigation process.<sup>329</sup> First, the allegation is initially evaluated to determine whether it should be investigated as a section 1203 violation. TIGTA has primary responsibility for investigating allegations under section 1203. The facts found as a result of the investigation are then reported to the IRS for evaluation. IRS managers then must determine whether a violation of Section 1203 has occurred. This determination is made by a Division-level or above manager, with

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<sup>327</sup> These laws are: (1) title VI or VII of the Civil Rights Act of 1964; (2) title IX of the Education Amendments of 1972; (3) the Age Discrimination in Employment Act of 1967; (4) the Age Discrimination Act of 1975; (5) section 501 or 504 of the Rehabilitation Act of 1973; or (6) title I of the Americans with Disabilities Act of 1990. IRS Reform Act, sec. 1203(b)(3)(B).

<sup>328</sup> IRS Reform Act, sec. 1203(b).

<sup>329</sup> See generally, IRS Letter at 51-53.

assistance of local labor relations specialists and the staff of the Centralized Adjudication Unit. The Centralized Adjudication Unit is involved in all determinations under section 1203 for the purpose of ensuring consistency throughout the IRS. If a determination is made that sufficient facts exist to support a section 1203 violation, the employee is given a letter advising that the IRS proposes to remove him or her from Federal service. The employee has a right to respond to the letter. The management official then must determine if the charge has been sustained by a preponderance of the evidence. If it is determined that the charge has been sustained, the case file is forwarded to the IRS national office for consideration by the Section 1203 Review Board.

The Section 1203 Review Board then reviews the case to determine whether a penalty less than termination of employment is appropriate. The Section 1203 Review Board submits recommendations for mitigation to the Commissioner. If the Section 1203 Review Board does not find mitigation appropriate, the case is not submitted to the Commissioner and the statutory penalty of removal is imposed.

As of March 31, 2001, there were 243 substantiated violations of section 1203.<sup>330</sup> Of the 243 substantiated violations, 213 were for failure to file a Federal tax return.<sup>331</sup> The Section 1203 Review Board has submitted 93 tax compliance cases (willful failure to timely file a return or willful understatement of tax) to the Commissioner.<sup>332</sup> The Commissioner has exercised the authority to mitigate the removal penalty in 50 of those cases.<sup>333</sup>

Seven employees have been removed for willful failure to timely file a Federal tax return when the employee was due a refund because he or she had overpaid the tax due.<sup>334</sup> The following information provided by the IRS, shown on Table 6, below, reflects all substantiated failure to file violations through December 31, 2000 considered by the Section 1203 Review Board.<sup>335</sup> An employee who did not file a return is assumed by the IRS to have had a balance due.

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<sup>330</sup> IRS Letter at 64.

<sup>331</sup> *Id.*

<sup>332</sup> IRS Letter at 44.

<sup>333</sup> *Id.*

<sup>334</sup> This includes employees that resigned or retired before the IRS implemented the removal action. IRS Letter at 42.

<sup>335</sup> IRS Letter at 42-43.

**Table 6.--Substantiated Failure to File Violations**

| Grade      | Refund         |                  | Balance Due    |                  | Total |
|------------|----------------|------------------|----------------|------------------|-------|
|            | <i>Removed</i> | <i>Mitigated</i> | <i>Removed</i> | <i>Mitigated</i> |       |
| 2          | 0              | 0                | 1              | 0                | 1     |
| 3          | 1              | 5                | 5              | 1                | 12    |
| 4          | 2              | 7                | 2              | 4                | 15    |
| 5          | 0              | 3                | 7              | 2                | 12    |
| 6          | 1              | 2                | 7              | 1                | 11    |
| 7          | 1              | 7                | 8              | 2                | 18    |
| 8          | 0              | 2                | 3              | 2                | 7     |
| 9          | 0              | 3                | 2              | 1                | 6     |
| 10         | 0              | 0                | 0              | 0                | 0     |
| 11         | 0              | 0                | 0              | 2                | 2     |
| 12         | 1              | 1                | 0              | 0                | 2     |
| 13         | 1              | 2                | 1              | 0                | 4     |
| 14         | 0              | 1                | 0              | 1                | 2     |
| 15         | 0              | 0                | 0              | 0                | 0     |
| Executive  | 0              | 0                | 0              | 0                | 0     |
| Wage Grade | 0              | 1                | 0              | 0                | 1     |
| Total      | 7              | 34               | 36             | 16               | 93    |

Source: Internal Revenue Service.

Many employees and managers believe that the removal sanction for employee tax compliance violations is too harsh in some cases.<sup>336</sup> The IRS indicates that the anxiety level of employees has increased since the IRS statistics show that the vast majority of cases are based on tax compliance.<sup>337</sup>

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<sup>336</sup> See IRS Letter at 44, 59-62.

<sup>337</sup> *Id.* at 44.

## V. THE 2001 FILING SEASON

### A. Overview

For the 2001 tax filing season, which Commissioner Rossotti referred to as having been “smooth and almost error free,” the IRS has projected that net collections for fiscal year 2001 will exceed the \$1.9 trillion collected for fiscal year 2000.<sup>338</sup> For fiscal year 2001, the IRS also projects that it will receive 215.4 million returns, including over 130.3 million individual returns, and it expects to issue over 96.8 million individual refunds. As of March 9, 2001, the IRS reported that the average dollar amount per refund was up over five percent from last year, and the average refund as of that date was \$1,823.<sup>339</sup> The IRS recently announced that 34.2 million tax returns were filed electronically as of April 6, 2001.<sup>340</sup>

At the request of the Subcommittee on Oversight of the House Committee on Ways and Means (“Oversight Subcommittee”), the General Accounting Office reviewed the IRS’s performance during the 2001 filing season. In its April 3, 2001, testimony before the Oversight Subcommittee, the General Accounting Office made four specific observations. First, the General Accounting Office noted that the IRS’s reorganization had little effect on the 2001 filing season, although some improvements to customer service are still needed. Second, the General Accounting Office reported that the IRS processed returns and refunds without any significant problems and has received a larger percentage of returns electronically, but the growth rate of electronic filing is slower than expected, and many taxpayers encountered trouble using their personal identification number (instead of signatures filed on paper). Third, according to the General Accounting Office, the IRS has done a better job answering telephone calls, although there remain concerns about the declines in the productivity of telephone assistants. Finally, the General Accounting Office finds continuing concerns regarding the quality of tax law assistance being provided by IRS walk-in sites, despite the increased staffing of the IRS field assistance program.<sup>341</sup>

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<sup>338</sup> Statement of Charles O. Rossotti, Commissioner of Internal Revenue, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 3, 2001) (hereinafter “Rossotti April 3, 2001, Testimony”) at 8.

<sup>339</sup> *Id.*

<sup>340</sup> “Selected IRS Tax Filing Statistics,” Associated Press, April 12, 2001, available at <[http://www.washingtonpost.com/wp-srv/aponline/20010412/aponline131909\\_000.htm](http://www.washingtonpost.com/wp-srv/aponline/20010412/aponline131909_000.htm)> (hereinafter “A.P. April 12, 2001, Article”).

<sup>341</sup> Statement of James R. White, Director, Tax Issues, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 3, 2001) (“hereinafter GAO April 3, 2001, Statement”) at 2.

## B. Electronic Tax Administration

### In general

The IRS has reported that, as of April 6, 2001, 34.2 million tax returns were filed electronically, which is an 11.6 percent increase from the same period last year. Of these returns, 30.3 million were filed via computer, up 16.2 percent from the same period last year. In addition, 3.8 million of these returns were filed over the telephone, using the *TeleFile* system, which was down 14.7 percent from the same period last year.<sup>342</sup> Oklahoma and Georgia joined Kentucky and Indiana in the Federal/State *TeleFile* option.<sup>343</sup> In addition, the IRS has reported that 11 million taxpayers chose to file both their federal and state tax returns simultaneously in a single electronic transaction, using Federal/State *e-file*.<sup>344</sup> This year, 35 states and the District of Columbia are participating in the program.

The General Accounting Office has found that, although the percentage of returns file electronically has increased, the rate of increase is below expectations. Based on this observation, both the IRS and the General Accounting Office find that it will be challenging for the IRS to reach its mandated goal of having 80 percent of all returns filed electronically by 2007.<sup>345</sup>

For the 2001 filing season, the IRS has set out to improve its electronic tax administration program, in order to ease taxpayer burden and make electronic filing more attractive. In addition, the IRS's Web site and CD-ROMs continue to provide support and resources for taxpayers and practitioners.

The Taxpayer Advocate Service recognizes the importance of electronic tax administration; nonetheless, National Taxpayer Advocate, Nina E. Olsen, has identified low-income taxpayers as a group that may "be left behind in the push for electronic filing."<sup>346</sup> According to the National Taxpayer Advocate, such individuals' options for filing a tax return include filing a paper return and waiting four to six weeks for a refund, or retaining a tax

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<sup>342</sup> A.P. April 12, 2001, Article.

<sup>343</sup> Federal/State *TeleFile* allows taxpayers to file both Federal and State returns in a single telephone call. See IR-2001-29. As of March 1, 2001, more than 148,000 taxpayers filed both Federal and State returns by using this system. *Id.*

<sup>344</sup> Federal/State *e-file* allows the electronic filing of both Federal and State income tax returns at the same time. *Id.*

<sup>345</sup> Rossotti April 3, 2001, Testimony at 8; GAO April 3, 2001, Testimony at 6. *See also* section 2001 of the IRS Reform Act.

<sup>346</sup> Statement of Nina E. Olsen, National Taxpayer Advocate, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 3, 2001) (hereinafter "Olsen April 3, 2001, Testimony") at 4.

preparer and paying a return preparation fee, a second fee for electronic submission of the return, and a third fee for obtaining a refund anticipation loan (if they need refunds immediately).

### **Electronic filing for individual taxpayers**

#### Expansion of the e-file program

The IRS is expanding availability of the *e-file* program, by increasing the number of different forms that taxpayers may file electronically. For example, for the 2001 filing season, the IRS added 23 additional forms to the individual e-filing program.<sup>347</sup> The IRS expects that the remaining 38 forms will be eligible for electronic filing for the 2002 filing season, which will make e-filing available to 99.1 percent of all taxpayers.<sup>348</sup>

#### Personal identification numbers in lieu of paper signatures

The IRS is in the process of making the e-filing process entirely paperless. In prior years, the taxpayer's signature (on paper) was required to be filed with an electronically-filed return. In 2000, the IRS successfully tested the use of a personal identification number code in lieu of a paper signature. This year, the program was extended to taxpayers nationwide. Thus far, four million taxpayers have utilized the personal identification number option.<sup>349</sup>

According to the General Accounting Office, as of March 11, 2001, approximately 5.9 million returns had been filed electronically using a self-selected personal identification number. The General Accounting Office also indicated that returns filed electronically using a self-selected personal identification number had a higher reject rate (approximately twice as high as the rate usually experienced with electronic filing), which caused additional burdens for taxpayers utilizing this program.<sup>350</sup>

#### Expanded payment options

In the 2001 filing season, the IRS has offered more electronic payment options than have been available in the past. For example, debit payments may not be made through *TeleFile*, and credit card payments may be made for estimated tax payments on Form 1040ES, as well as with Form 4868, "Automatic for Automatic Extension of Time To File U.S. Individual Income Tax Return." The IRS has reported that, as of March 10, 2001, 22,718 credit card payments

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<sup>347</sup> Rossotti April 3, 2001, Testimony at 9. Example of the additional forms that may now be filed electronically include Form 2106-EZ, "Unreimbursed Employee Business Expenses," Form 2688, "Application for Additional Extension of Time To File U.S. Individual Income Tax Return," and Form 8379, "Injured Spouse Claim and Allocation."

<sup>348</sup> *Id.*

<sup>349</sup> *Id.*

<sup>350</sup> GAO April 3, 2001 Testimony at 8.

(averaging \$3,177) were made and another 24,064 payments (averaging \$1,026) were made by direct debit from taxpayers' checking or savings accounts.<sup>351</sup>

### E-Services and business systems modernization

The IRS's e-Services project under business systems modernization are expected to lead to the IRS being able to conduct most transactions with taxpayers and their representatives in an electronic format. By 2002, the IRS hopes that e-Services will: (1) provide the ability for new electronic return originators to register electronically over the internet, (2) allow electronic delivery of taxpayer transcripts to authorized parties, and (3) allow those parties who are required to file Form 1099 and other information returns to verify the accuracy of taxpayer identification numbers prior to submission.<sup>352</sup>

### Marketing the e-file program to taxpayers

The IRS's notes that its marketing campaign for promoting electronic filing, "40 Million People Already Know e-file is the Way to Go," has contributed to the success of the electronic filing season. The IRS has developed a fully integrated campaign with television, radio, and print advertising of the e-file program. The IRS plans to shift emphasis of its advertising campaign from awareness of the program, to emphasizing its value, such as saving taxpayers time.<sup>353</sup>

### Electronic filing for business taxpayers

The IRS has reported that has expanded electronic filing options for business taxpayers. For example, since April 2000, employers could file electronically Forms 941, "Employer's Quarterly Federal Tax Return." Forms 941 and 940, "Employer's Annual Federal Unemployment (FUTA) Tax Record," also will be able to be filed electronically by companies and payroll service providers. Direct debit payments also was made available through Form 941 *TeleFile*. Employers also have the option of providing certain information statements, such as Forms W-2, "Wage and Tax Statement," to taxpayers electronically, rather than on paper.<sup>354</sup>

The IRS further noted that, in 2002, the electronic federal tax payment system ("EFTPS") was very successful. For example, the system processed over 63 million federal taxpayments (a 14 percent increase from 1999) and received \$1.5 trillion (a 15 percent increase from 1999). The IRS credits the success of this system to a high level of service and accuracy for payments applied properly. The IRS is conducting a new pilot program to test its Internet-based

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<sup>351</sup> Rossotti April 3, 2001, Testimony at 9.

<sup>352</sup> *Id.*

<sup>353</sup> *Id.*

<sup>354</sup> *Id.* at 10.

application for businesses to pay taxes online. EFTPS-OnLine would allow business to enroll in the system, securely make federal payments, and check payment history online.<sup>355</sup>

### **IRS Web site**

The IRS's Web site, known as the "Digital Daily,"<sup>356</sup> provides tax information and resources to taxpayers and practitioners. The IRS has noted that the "Digital Daily" has received nearly 1.3 billion hits this fiscal year. The "Digital Daily" provides:

- tax forms, instructions, and publications;
- the latest tax information and tax law changes;
- tax tables and rate schedules;
- hypertext versions of all taxpayer information publications;
- all TeleTax topics;
- answers to the most frequently asked tax questions;
- a library of tax regulations; and
- the weekly Internal Revenue Bulletin, which contains the latest revenue rulings, revenue procedures, notices, announcements, and proposed and final regulations.

Earlier this year, the IRS launched its new "Small Business and Self-Employed Community" Web page, which can be accessed from its Web site. This Web page is designed to benefit small business owners and self-employed and start-up business owners. Moreover, for the first time, the IRS is offering industry-specific tax information for the construction and restaurant industries. For example, those in the food industry can access the Web site and receive information regarding tip reporting.<sup>357</sup>

### **CD-ROMs**

More than 600 tax forms and instructions for the current tax year (as well as an archive of forms and instructions back to 1992) can be obtained on the Federal Tax Forms CD-ROM. In addition to the tax forms, 3,000 pages of tax information also is available on CD-ROM. Taxpayers can search, view on-screen, and print any of the information contained on the CDs.

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<sup>355</sup> *Id.*

<sup>356</sup> The IRS's Web site is available at <<http://www.irs.gov>>.

<sup>357</sup> Rossotti April 3, 2001, Testimony at 11.

The CDs also contain all the business tax forms, publication and instructions for electronic filing of tax returns and information.

### **C. Telephone and Walk-In Service**

#### **Telephone service**

The IRS offered 24-hour, seven-days-a-week telephone assistance throughout the 2001 filing season. After April 16, 2001, the IRS has been providing around-the-clock service for refund and account callers, and service for tax law assistance will be provided Monday through Saturday from 7:00 a.m. until 11:00 p.m.

The IRS notes that, through March 9, 2001, approximately 65 percent<sup>358</sup> of taxpayers who wanted to speak with a customer service representative got through, compared to 61.7 percent at the same time in 2000. While the IRS finds this level of service “unacceptable,” it does find that the increases in phone service are “encouraging,” showing benefits from its investments in training, management, and technology.<sup>359</sup> The IRS further noted that it is unable to provide taxpayers with up-to-date information on their accounts, which causes frustration for both taxpayers and the IRS.

The General Accounting Office has found that telephone assistance is less than what it could be because, first, telephone assistor productivity (i.e., how quickly assistor complete telephone calls) has declined for the third successive filing season, and second, implementation of the IRS’s Customer Communication Project has been delayed.<sup>360</sup>

#### **Walk-in service**

Walk-in service is available at more than 400 locations throughout the United States. At many walk-in sites, service was offered on 12 Saturdays between January 27, 2001, and April

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<sup>358</sup> The General Accounting Office found that, as of March 17, 2001, the 2001 level of telephone service at 76 percent, which it attributes to the data in 2001 not accounting for taxpayers who may have abandoned their calls before getting an answer. GAO April 3, 2001, Testimony at 10. The Treasury Inspector General for Tax Administration reported that the Inspector General’s auditors were able to gain access to a customer service representative 63 percent of the time (based on 368 random test calls). Statement of the Honorable David C. Williams, Inspector General, Treasury Inspector General for Tax Administration, U.S. Department of the Treasury, before the Subcommittee on Oversight of the House Committee on Ways and Means (April 3, 2001) (hereinafter “TIGTA’s April 3, 2001, Testimony”).

<sup>359</sup> Rossotti April 3, 2001, Testimony at 12.

<sup>360</sup> GAO April 3, 2001, Testimony at 12. The Customer Communication enhancements are designed to free-up assistors so they may handle more calls by routing and answering calls through automation. *Id.*

14, 2001.<sup>361</sup> The IRS hopes to broaden the services available at its local offices, with the assistance of additional personnel provided by the STABLE initiative. A new job category, called Tax Resolution Representative, will have the training and authority to provide one-stop service to taxpayers for issues ranging from answering tax questions to resolving payments problems.<sup>362</sup>

According to the General Accounting Office, Taxpayer Assistance Centers provide poor quality of tax law assistance to taxpayers. The General Accounting Office reported that IRS employees posing as taxpayers conducted 272 visits to Taxpayer Assistance Centers before the 2000 filing season and another 272 visits during the 2000 filing season. IRS's final report on the combined results indicated that, although 92 percent of assistors spoke to reviewers in a pleasant manner, 81 percent of the reviewers' questions were not answered correctly, and 21 percent of the reviewers were denied service.<sup>363</sup>

#### **D. 2001 Revenue Protection Strategy**

##### **In general**

During the 2001 filing season, validation of social security numbers and other tax identification numbers has been a significant portion of the IRS's fraud and abuse prevention efforts.<sup>364</sup>

The National Taxpayer Advocate has recommended that the IRS strengthen its validation procedures.<sup>365</sup> IRS Operations and the Taxpayer Advocate Service have worked together in developing what is referred to as a "soft" notice for taxpayers with secondary social security number problems. This notification allows taxpayers to correct their records before the filing of their next tax return. The Taxpayer Advocate Service estimates that 1.8 million taxpayers will have received such notice in fiscal year 2000. The National Taxpayer Advocate notes that this has prevented taxpayers' 2000 refunds from being frozen before taxpayers had an opportunity to resolve this issue.

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<sup>361</sup> As of April 3, 2001, the IRS estimates that it had served over 3.37 million taxpayers at all Taxpayer Assistance Centers, which is a 4.54 percent decrease from 2000. Rossotti April 3, 2001, Testimony at 12-13.

<sup>362</sup> *Id.*

<sup>363</sup> *Id.* at 15.

<sup>364</sup> Rossotti April 3, 2001, Testimony at 7.

<sup>365</sup> National Taxpayer Advocate FY 2000 Report at 111-112.

## **Earned income credit**

The IRS plans to continue its emphasis on improving compliance with the earned income credit, including use of the IRS's Dependent Database<sup>366</sup> to identify questionable issues regarding the status of earned income credits, dependent exemptions, and filing status. In addition, the Earned Income Tax Credit Preparer Outreach Program also will continue. This program included visits by IRS revenue agents to tax professionals nationwide prior to January 2001, to provide assistance and answer questions regarding the earned income credit. Some of these visits also included a review of files to determine if the due diligence requirements of the earned income credit have been met.<sup>367</sup>

Regarding the accuracy of the Dependent Database, the IRS noted that approximately 10,000 returns were selected for examination between March 15 and May 2, 2000.<sup>368</sup> Return selection criteria was most successful when combined with other IRS data on filing characteristics and duplicative claims of children for dependency exemptions and for the earned income credit. Based on the results of this examination, the IRS identified some limitations on the usefulness of its data. These limitations include:

- the new Social Security Administration data, linking parents' social security numbers to those of their children, remains limited because of the short time the Social Security Administration has been gathering the data;
- the Health and Human Services data records were created in the system (thus, the IRS is unable to determine whether documents provided by taxpayers are more current than Health and Human Services records);
- the data contains inconsistencies because the Health and Human Services database is reliant on data provided by the individual states (these inconsistencies include multiple records for the same child and missing data elements, such as the social security number for the child or the custodial party); and
- not all of the states are providing all of their records (in December 2000, Health and Human Services indicated that four states had no records for children and two had partial records).<sup>369</sup>

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<sup>366</sup> The Dependent Database includes records from the Social Security Administration and the Office of Child Support Enforcement at Health and Human Services. These records link the names and social security numbers of dependent children with the names of their parents and their parents' social security numbers, along with custody and child support obligation information.

<sup>367</sup> National Taxpayer Advocate FY 2000 Report at 111-112; *see also* Olsen April 3, 2001, Testimony at 3-4.

<sup>368</sup> IRS Letter at 82.

<sup>369</sup> *Id.* at 82-83.

The IRS has noted that, this year, it will use the Dependent Database application nationwide, with enhanced selection criteria, as part of the examination program and for the identification of noncompliant taxpayers and paid preparers. The IRS also indicated that it will conduct examinations prior to the release of tax refunds, and, thus expects revenue protection in fiscal year 2001. In addition, the IRS expects education and outreach efforts to result in revenue protection measurable by the reduction in error rates in returns filed during the 2002 filing season.<sup>370</sup>

The National Taxpayer Advocate has stressed that statutory and procedural changes to the earned income credit, which were developed to reduce error and fraud, must also protect the rights of taxpayers. The National Taxpayer Advocate has noted that, in many cases, taxpayers who claim the earned income credit do not have professional assistance in doing so, because of poverty, or, due to language or literacy barriers, cannot make an effective claim for themselves. In addition, the National Taxpayer Advocate has observed that the Dependent Database must be regularly and correctly updated to work properly and efficiently.<sup>371</sup>

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<sup>370</sup> *Id.* at 83.

<sup>371</sup> Olsen April 3, 2001, Testimony at 3-4.

## APPENDIX

March 15, 2001

Lindy L. Paull  
Chief of Staff  
Joint Committee on Taxation  
Congress of the United States  
Washington, DC 20515-6453

Dear Ms. Paull:

I am pleased to respond to your letter of March 7, 2001 concerning the operations of the IRS Oversight Board. As you know the Board began operations in September 2000 after our Senate confirmation. Our first meeting was held September 29, 2000. As required by the IRS Restructuring and Reform Act of 1998 we will be issuing a complete report of our activities, findings and recommendations at the end of the fiscal year.

Responses to Questions

**Question 1 (a): What challenges has the Oversight Board faced in accomplishing its duties? For example, has the Oversight Board had difficulty assembling a staff to assist the Board members? Has the Oversight Board been able to secure sufficient information from the IRS to evaluate the needs and operations of the IRS?**

The primary challenge that the Oversight Board has faced is coming up to speed on the learning curve of IRS operations, issues and problems. As you know, the IRS is a large, complex organization that is currently going through a massive program of change. The Board consists of seven private citizens who serve on a part time basis. Each of these individuals has other responsibilities and interests that limit their participation on Board activities. Based on the prior experience of the Board members we also started with different levels of knowledge of the IRS. The Secretary of the Treasury and the IRS Commissioner are also members of the Board.

The Board made a decision at our first meeting to start with a very small staff. We felt that this was consistent with our overall approach of providing oversight at the strategic level. We also knew that there were other organizations, in particular the GAO and TIGTA that reviewed and audited the IRS' operations at a very detailed level. We brought on an interim Staff Director who was detailed to us from Treasury and hired a part time Communications Director. We learned that we needed a much more experienced Staff Director and we are currently in the process of bringing on such an individual. As soon as that individual is on board, hopefully within the next few weeks, we will examine our need for additional staff.

The Board has had no difficulty in receiving the necessary information or access from the IRS. The IRS has been completely cooperative in providing the information we need, supporting our activities and providing open access to any people we want to speak with. The Treasury Department has also been completely supportive of our needs, particularly as it relates to administrative support.

I want to particularly acknowledge and thank former Secretary Summers and Secretary O'Neill for their support, interest and participation. Despite extremely busy schedules they have both shown a commitment to work with the Board and make it a success.

**Question 1 (b): How does the Oversight Board plan to address the challenges it has identified?**

The Board is addressing the knowledge curve challenge by hard work. We meet every two months for two days. We receive and study extensive background material in preparation for our meetings. We have organized ourselves into three committees to focus on areas of particular interest: Modernization, Personnel and Organization, and Performance Management. These committees and individual Board members have spent additional time on important issues.

Bringing on board an experienced Staff Director and a limited number of additional staff will also allow us to insure that we carry out our responsibilities thoroughly and carefully.

We have also started work on a strategic plan for the Board. This will document in a precise manner how we will operate and what areas of IRS operations we will focus on.

**Question 2 (a): How has the Oversight Board been involved in the development of the IRS budget?**

As soon as the Board was established we realized that we had to immediately focus on the IRS budget for fiscal year 2002. Starting with our first meeting in September 2000 we received extensive briefings on the budget process, the 2001 budget and operating requirements for 2002 and beyond. We reviewed and approved the IRS strategic Plan, their first, and assured ourselves that the 2002 budget was consistent with and supported the plan. We spent a significant portion of our November and January meetings reviewing and discussing the budget and formally approved the budget in a Board conference call on February 26, 2001.

The Board is confident that we understand what resources are needed to accomplish the goals of the IRS as defined by Congress and as documented in their Strategic Plan. We are also confident that the budget we are recommending is necessary, adequate but

certainly not excessive to meet those goals. The Board is very disappointed that the Administration did not consult with us before finalizing their budget recommendation.

**Question 2 (b): In the Oversight Board's opinion, what are the critical areas for funding as they relate to the strategic plans of the IRS?**

The IRS does not effectively or efficiently serve the needs of the American taxpayer, and it will not, until the comprehensive modernization program that was started 2 ½ years ago is completed. The Board is recommending that this program be funded at the \$450 million level for fiscal year 2002. This is not an arbitrary amount. It is based on a detailed plan. The plan was created with the objective of completing modernization as quickly as possible, given the ability of the IRS to absorb change and manage the program. The Administration's recently released Budget Blueprint recommends funding the Information Technology Investment Account (ITIA) at \$400 million. This level of funding unnecessarily slows down a program that is already taking too long and does not take into account the need to provide multi year funding as described in the following paragraph.

The Board also recommends that the ITIA be funded for an additional \$550 million to support the modernization program through fiscal year 2003, bringing the total ITIA appropriation to \$1 billion. This multi-year funding of ITIA is consistent with one of the key objectives of the fund, insuring that the program does not suffer from the inefficiencies of unnecessary slowdowns. The ITIA was funded for multi year periods in its early years but will be at a zero level by the end of this fiscal year.

The Board has recommended that \$54 million be provided in the 2002 budget to start a program of upgrading desk-top and lap-top computers on a three year cycle. This is a proven policy that is followed by most large American companies. In addition it is particularly needed at this point to support the roll out of new and standardized software that will improve security and provide more efficient functionality for IRS employees. The software being developed by the modernization program will not operate on the desktop and laptop computers currently used by many IRS employees. This computer upgrade program is a necessary part of modernization and it is foolish not to fund it.

Congress provided funding in 2001 to start a program called Staffing Tax Administration for Balance and Equity (STABLE). The objective of STABLE is to fund the increase of IRS personnel by approximately 4,000 professionals over a two-year period (2001 and 2002), particularly in the areas of taxpayer service and enforcement. This much needed staff increase reverses a decade long 15% decrease in headcount that occurred while the agencies workload increased significantly. While modernization, not headcount increases, is the long-term strategy for improving IRS operations, this immediate headcount increase is necessary to provide improvements in service being demanded by both Congress and the countries taxpayers.

The Administration's budget blueprint indicates that it supports the completion of STABLE in 2002, but this statement is misleading. Their recommended budget will require that the approved level of 4,000 additional personnel be reduced by approximately 1,300. The Board believes that the 4,000 person increase envisioned by STABLE is consistent with the IRS strategic plan and the important objective of providing improved service levels as quickly as possible. We recommend the funding levels that will support this program.

**Question 3 (a): Over the past several years, the level of IRS audit coverage has declined significantly. What recommendations, if any, has the Oversight Board made to the IRS regarding this issue?**

Response: The Board believes that an active audit program is necessary to insure that all taxpayers obey the tax law and pay their fair tax bill. While we have not had time since we started work to look into all of the reasons for the decrease in the level of audits and other enforcement activities, it appears obvious that the significant headcount reduction discussed above has had a serious impact. In the short-term we believe that the full implementation of STABLE, as described above, will help address this issue. It is the Board's intention to study this matter further in future months.

**Question 3 (b): Has the IRS responded to these recommendations, and, if so, how?**

Response: Other than supporting the full implementation of STABLE in the 2002 budget the Board has made no other recommendations to the IRS on this issue.

**Question 4: Please summarize the significant activities of the Oversight Board to date.**

Response: As previously indicated, the Board was approved by the Senate in September 2000 and held its first meeting on September 29, 2000. Subsequent two-day meetings were held in November 2000 and January 2001 and a telephone conference meeting was held on February 26, 2001. The focus of our activities have been:

- (1) Education on IRS operations
- (2) Organizing ourselves into three committees
- (3) Reviewing and approving the IRS Strategic Plan
- (4) Reviewing and approving the fiscal year 2002 budget
- (5) Actively participating in the evaluation of the Taxpayer Advocate and advising the Secretary of the Treasury on this appointment
- (6) Participating in the selection of a new CIO
- (7) Starting to build a professional staff for the Board

**Question 5: What problems or concerns has the Oversight Board identified as a result of its oversight activities and what recommendations, if any, have been made to the IRS to address these issues?**

Response: The problems faced by the IRS are almost too numerous to list. We are quite sure that the Board has not identified all of these problems, although the Commissioner and other senior executives have been very forthcoming in discussing these issues. One obvious problem that is clearly outside the scope of the Board's responsibility is the complexity of the tax code. As long as the tax code is as complex as it is today, the operations of the IRS and the service it provides to taxpayers will be negatively impacted.

One logical way to summarize the problems of the IRS is to state that it is not meeting any one of the three strategic goals and objectives defined in its Strategic Plan:

*THE IRS DOES NOT "Provide top-quality service to each taxpayer in every interaction"* – for example, phone calls frequently go unanswered and notices to taxpayers are often difficult to understand.

*THE IRS DOES NOT "Provide top-quality service to all taxpayers through fair and uniform application of the law"* – for example, as discussed above, the level of audits and other enforcement levels have fallen to an unreasonably low level.

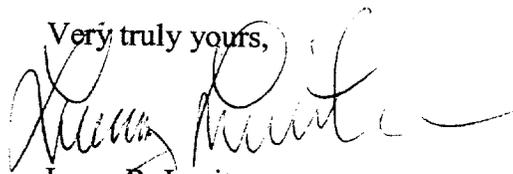
*THE IRS DOES NOT "Provide productivity through a quality work environment"* – because of outdated technology the work environment is completely inconsistent with efficient and modern practices.

These problems are well understood by Congress and the IRS. They have been the subject of public hearings and directly led to the IRS Restructuring Commission and the passage of the IRS Restructuring and Reform Act of 1998. The Board is also convinced that progress is being made to address to these problems. A Modernization program is under way, management has been strengthened and the newly published Strategic Plan lays out a logical approach for moving towards success.

At this point the major recommendation of the IRS Oversight Board is to stick with the program that is underway and execute it aggressively. Success will depend on continuous and effective management and leadership by the IRS as well as vigilant oversight and consistent support by Congress.

In closing, the Board appreciates this opportunity to provide a report of its activities and findings to the Joint Committee on Taxation of the Congress of the United States. We look forward to reporting in more detail as we gain additional experience. Please don't hesitate to call me if you have any additional questions.

Very truly yours,



Larry R. Levitan  
Chairman  
IRS Oversight Board

# National Association of Enrolled Agents

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April 5, 2001

Ms. Lindy L. Paull  
Chief of Staff  
Joint Committee on Taxation  
Congress of the United States  
Washington, DC 20515-6453

Dear Ms. Paull:

I am pleased to respond to your recent letter requesting the comments of the National Association of Enrolled Agents with respect to the IRS budget and strategic plan. I am also attaching a copy of my testimony before the Ways & Means Oversight Subcommittee on April 3. It addresses more completely our thoughts in these areas.

Following are our replies to your questions:

*1. The IRS Restructuring and Reform Act of 1998 contained many provisions that enhance taxpayer rights, including expanding the availability of innocent spouse claims and offers in compromise and providing new taxpayer due process protections in collection, such as pre-lien and pre-levy hearings and court review of such hearings.*

*a) Are practitioners utilizing the new procedures? If yes, to what extent are they utilizing them?*

Yes, our Members are using the new procedures and NAEA is offering our members additional training in use and procedures in these areas through our National Tax Education Institute. As it is now filing season, we are not receiving much in the way of feedback as to how they are utilizing them. However, we know there is a severe backlog in innocent spouse claims. We are also hearing that OIC requests are backing up, again because many IRS employees are being drafted to assist taxpayers with filing season issues.

*b) What has been their experience with these new procedures?*

Our members at the local level tell us that IRS has been slow in training its field personnel and lacks sufficient field lead strength to respond to many of these requests for relief. We have learned that many attorneys, as a matter of course, submit innocent spouse requests in divorce proceedings. This jams up the system with cases that may not have any merit whatsoever. The attorneys respond that they want to avoid malpractice claims. Somehow, there has to be a better way. Perhaps more guidance is warranted.



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Members Licensed to Represent Taxpayers Before The Internal Revenue Service

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*c. Has the IRS been responsive in such actions? For example, have pre-lien or pre-levy hearings been effective.*

It is our members' perception that very few have actually taken place. Collection actions are held at bay in wait for hearings.

*d. Have practitioners observed expanded availability of offers in compromise as provided in the IRS Reform Act? For example, has the IRS in practice been considering factors other than doubt as to liability of collectibility such as equity and hardship in determining whether to compromise a tax liability?*

We are seeing very inconsistent application of "equitable" OIC provisions. Some regions of the country interpret "equitable" differently than others and are unwilling to consider such offers.

*2. In an effort to modernize the IRS by organizing around its customers' needs, the IRS has established four new operating divisions.*

*a) What changes in practice have been observed as a result of the reorganization?*

IRS is still reorganizing, by which we mean that the restructuring is filtering down to the frontlines. Many practitioners are scrambling to hang onto their local contacts. There is a tremendous amount of moving around, almost like musical chairs. Where there were strong practitioner/IRS liaison offices, these are continuing. Where there were weak links or none, then we are still seeing weaknesses. However, it is early in the process and we are hopeful things will improve. We understand IRS has committed additional resources to practitioner outreach and we hope to see the results of these additional resources after filing season ends.

*b) Have practitioners been experiencing difficulties in contacting the appropriate office within the IRS?*

There has been a massive cultural shift at IRS. For the most part, employees are going the extra mile to assist practitioners, even with the difficulty of reorganization. Employees now routinely state their name and badge number. There is a more professional demeanor to interaction with the public and with the practitioner community. There is still a learning curve -- for both practitioners and IRS employees -- but we are seeing major improvements. A major issue: practitioners are still hopeful that practitioner hotlines will remain intact. These hotlines are vital for resolving taxpayer matters in a timely fashion. Someday, when IRS's legacy computers have been replaced and this work can be done by e-mail, we will be able to consider limiting the use of hotlines. We hope that time is not far off. At this moment, NAEA has 200 members working on a secure e-mail messaging pilot with IRS. Our members report limited success to date with this program, however, we look forward to an expansion of a truly working model to accomplish the goals of the project. Our efforts now, we hope, will contribute to that success.

*c) What difficulties if any have practitioners observed when clients have issues that involve multiple divisions of the IRS? Are taxpayers required to deal with more than one point of contact to resolve issues?*

We have not heard much about any difficulties in this area. However, we are still in filing season. We may hear more once filing season is over.

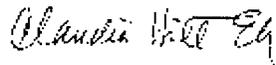
*d) Have practitioners experienced improvements in dealing with the IRS as a result of the IRS's reorganization? If so, what improvements have been observed?*

There have been some improvements. At the national level, the public liaison outreach is working extremely well. Still, it is early in the process and many practitioners are completely caught up with tax season. These are probably good questions to ask during the summer or in the early fall.

If you have any additional questions, please contact me or Sharon Cranford, NAEA's Director of Public Policy and External Relations.

With kindest regards,

Sincerely,



Claudia Hill, EA, MBA  
Chair  
Government Relations Committee

Enclosure

# *National Association of Enrolled Agents*

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Testimony of  
Claudia Hill, EA, MBA  
Chair of the  
Government Relations Committee  
National Association of Enrolled Agents  
Before the  
Oversight Subcommittee  
Committee on Ways & Means  
April 3, 2001



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*Members Licensed to Represent Taxpayers Before The Internal Revenue Service*

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**Testimony of Claudia Hill, Enrolled Agent  
Representing  
The National Association of Enrolled Agents**

I am honored Mr. Chairman to present this testimony on behalf of the National Association of Enrolled Agents (NAEA). There are approximately 35,000 Enrolled Agents, more than 10,000 of whom are members of our organization. Enrolled Agents represent over 5 million taxpayers and small businesses at all administrative levels of the IRS, including tax preparation. In order to be enrolled before the Department of Treasury, a practitioner must pass a detailed exam covering the administrative procedures and practical tax laws affecting real people and small businesses, or have significant experience working at the IRS. In addition to demonstrating ongoing competency each year through continuing education requirements, our members must undergo a thorough background check and abide by a strong code of conduct. Our members are proud to be the federal tax code specialists.

The Subcommittee has asked us to comment on the state of the filing season, and we are happy to report that from the perspective of frontline practitioners the state of the filing season is generally good. The IRS seems to be providing a basic level of service to more taxpayers with generally fewer resources at the same time that they manage annual tax code changes. They seem to be making progress with their strategic initiatives such as 80 percent electronic filing and business organization restructuring, while technology modernization has yet to materialize in terms of deliverables to taxpayers or frontline IRS employees. On the other hand, as there are in any undertakings as complex as filing season, there are some problems.

Before I touch on a number of specific problems our members have discovered with the current filing season, I would like to discuss a number of issues that affect the job IRS is doing with the filing season and with taxpayers service and compliance in general.

### **Resources**

Over the last decade, the IRS has been asked to do more with fewer resources. While the overall budget for the agency has grown in recent years, by many measurements it has declined.

First of all, the number of full time employees available to handle the workload for more taxpayers and more transactions has gone down over the last 10 years. At the same time, Congress has demanded and the Commissioner has delivered a greater emphasis on taxpayer service. While much of the technology infrastructure for a modern accounts management system is yet to be delivered, the IRS is generally doing a more professional job of handling case management issues and general tax questions from taxpayers. For example, our members continue to experience helpful and knowledgeable IRS employees. Generally, we have seen a strong positive change in attitude with employees at the agency.

Unfortunately, we also have witnessed a corresponding decline in service at the audit and collection functions. Experienced IRS employees in these areas are being reassigned to “cover the phones” and help with tax returns during filing season.

While at first glance, audits and collections activities do not seem to fit into the definition of “service,” resources available in these areas often assure the timely resolution of costly disputes for middle- income and small business taxpayers. An enrolled agent from North Carolina recently wrote to us telling of an incident where the single remaining auditor in Durham has been reassigned temporarily to customer service and will not be able to complete any ongoing audits until after April 16<sup>th</sup>. Without adequate resources, audits, which should take hours, spread out to days and even weeks. Meanwhile taxpayers are left with the uncertainty of knowing where they stand with the IRS. Other relief measures such as offers in compromise and innocent spouse claims are delayed to the point that many taxpayers are harmed needlessly.

It is our belief that adequate resources for the IRS make a difference in the public’s satisfaction with the IRS specifically, and the federal government in general. We also believe it is essential that IRS be given adequate resources to maintain an enforcement presence. Honest taxpayers need to know that there are consequences for non-compliance. When audit and collection efforts are reduced as greatly as they have been in recent years, it sends an ambiguous message about our voluntary tax system. Keep in mind, more citizens interact with the IRS than any other agency of the federal government. Their budget should reflect this reality.

## **Modernization**

This is the first filing season since the IRS finished its business reorganization. The purpose behind this complex and expensive undertaking is to organize the IRS around its customers so that they can better respond to the needs and track non-compliance of particular taxpayer groups. NAEA members are beginning to see some positive returns:

- Access to information has been dramatically enhanced with the continued improvement of the IRS web site. The incredible number of taxpayers and professionals visiting and using this site attests to the needs it has met.
- The Small Business/Self Employed Web site is a marvel of accessibility and usefulness. We hope to see it expanded and that other divisions will embrace this concept of providing information out where taxpayers and tax practitioners can access it easily.
- More forms are capable of being e-filed than ever before. We expect 99% of all forms to be capable of being e-filed by next filing season. Changes in the number of occurrences in which a form may be e-filed have also had a positive impact on the ability of taxpayers to e-file.

- Two hundred NAEA members are currently working with the IRS on a secure messaging system pilot program. It has taken longer than we expected for a variety of reasons, among them security concerns and the meshing of various computer systems and software, but this has been a project to which NAEA has been committed for a long time. It is meeting certain needs effectively for the practitioner community and we are gratified with the progress made thus far.
- The Communications and Public Liaison effort at IRS has been greatly enhanced. We are seeing the leveraging of the information systems of practitioner groups, the small business community and other business organizations to inform and advise the public on a broad range of issues. This is smart thinking and we applaud those who have run counter to the old IRS culture of "no comment."
- Partnerships between IRS and professional societies and trade associations are making it possible for us to develop solutions to long-standing issues in a timely and cost-effective manner.

While the business modernization seems to be taking its first tentative steps toward delivering value to taxpayers, it is clear that its full promise will not be delivered until the IRS and its contractors complete the information systems modernization. Our understanding is that a great deal of the initial planning and designing stages for the first projects are almost completed, and that IRS and its private sector partners are about to beginning building key elements of the project. Unfortunately, we have yet to see benefits delivered in the field.

The ability of the agency to collect more accurate data more efficiently and then to be able to better manage taxpayer data is key to the future of the IRS. Taxpayers will see their refunds faster. Practitioners and individual taxpayer will be able to resolve more problems with one or two calls instead of dozens. Additionally, the new system will allow taxpayers and practitioners more options for solving problems like 800 lines and online access and management of accounts. The IRS will be able to spot non-compliance faster making it cheaper for both taxpayers and the IRS to resolve these problems. Currently, it takes the IRS over 18 months to reconcile tax returns with information from 3<sup>rd</sup> parties such as W-2 and 1099 information. Modern systems and business practices should shorten this cycle considerably.

Our message to Congress is stay the course in these investments and make sure the IRS and its partners begin delivering benefits to taxpayers on schedule.

### **Complexity and the "Tax Headache of the Year"**

Every year, we survey our members on problems with the filing season. Separate from this effort, we ask our members to choose the most complex item in the Internal Revenue Code. We have dubbed their selection the "Tax Headache of the Year." For the second time in two years, the overwhelming response in both cases has been the same – the

individual alternative minimum tax. We believe the message is clear: Complexity is the number one tax filing season problem.

Why is the AMT the “Tax Headache of the Year?” Our members tell us of increasing numbers of their clients who were blindsided this year by falling into this insidious alternative tax system. Here are a few examples:

One of our enrolled agents in Youngstown, Ohio wrote to us to say how deeply troubled she was to see an elderly client “clobbered by the AMT.” The taxpayer was caring for his wife with Alzheimer’s, and had to withdraw extra pension money to pay medical bills. The AMT calculation required him to add-back into AMT a portion of his otherwise deductible medical bills and his state income and property taxes. This caused the AMT to exceed the regular tax. He didn’t think it was a good alternative!

In my state of California, I find that many middle-income taxpayers fall unwittingly into the AMT because of the high cost of property taxes on their homes and equally high state income taxes. When these taxpayers also happen to be employees who incur ordinary and necessary business expenses and whose employers either do not reimburse expenses or use “not accountable plans,” they are injured even more, since those miscellaneous deductions are also added back to the AMT base. None of these items, normally allowable deductions, are permitted against AMT.

Our members are reporting that more and more farm families are being hit with the AMT. Congress saw a need to provide farmers a special income averaging method a few years ago. Unfortunately, when that method lowers the regular tax below AMT, the taxpayer loses the benefits, and must pay the higher AMT.

U S taxpayers living outside our country are provided in the law a means to avoid double taxation through the use of foreign tax credits (FTC). Once again, AMT undermines the intent of fairness Congress intended with the credit system, by allowing the FTC to offset no more than 90% of the AMT while the regular tax can be completely offset. The taxpayer is injured once again.

Although Congress may be considering an extension allowing use of non-refundable child and education related credits against AMT, general business credits still cannot be used against the AMT. In example, for taxpayers that are affected, the benefits of the low-income housing credit are not allowed against the AMT – a Code provision that is essential for providing affordable houses in high-cost states.

With increasing emphasis on equity-based compensation, the use of employee stock options as part of a worker’s compensation package has become mainstream. Nearly 30 percent of those surveyed as part of the 35<sup>th</sup> Index of Investor Optimism<sup>1</sup> reported that they or their spouse had received options at some point in their career. Of this group, 43 percent said options were part of their 2000 compensation and comprised approximately

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<sup>1</sup> The Gallup Organization conducts this poll annually. Additional information about the Index of Investor Optimism can be found on UBS PaineWebber’s Web site: [www.ubspainewebber.com](http://www.ubspainewebber.com).

11 percent of their total income last year. However, during this past year a hidden danger of employee stock options became apparent. When an employee exercises their right to acquire incentive stock options at a price below the fair market value of the shares on the date of exercise, the “virtual income” (difference in values) is included in the AMT base but not in the regular tax base. The date of exercise value sets the preference—regardless of what eventually happens with the value of the shares if they are not disposed of in the same calendar year as exercise. If the employee chooses to hold the stock for the one year period prescribed in the law to obtain capital gains treatment of the income, they may find themselves expected to pay taxes on income they never really receive.

There have been many accounts in the media recently of taxpayers that have been injured by this “preference” because of dramatic volatility in the stock market this past year. We have heard from taxpayers and their advisors with egregious examples of phantom income far exceeding any economic benefit the taxpayers will ever receive, being taxed due to the provisions of the Alternative Minimum Tax (specifically IRC 55 and 56 and Regs. Sections 1.421 and 1.422). A taxpayer from San Luis Obispo, CA wrote,

“Ideally, “ISOs works for both employer and employee. It gives the employee an incentive to stay with the company and it gives the company ways to reward the employee without increasing salary costs...I exercised the stock options not realizing that the price of the stock on the day I exercise will be used to figure out my income WHETHER I ACTUALLY SELL THE STOCK OR NOT. Now that the value of our stock has been depressed over 60%, I am being taxed on income that was never realized and have what is call a PHANTOM INCOME. This made my effective tax rate to be 290%!”

This certainly was not what Congress intended. We hear of people mortgaging or selling their homes to pay their year 2000 AMT. Others are so distraught they fear filing their 2000 tax returns because they cannot pay the liability. This certainly was not what Congress intended.

Over three years ago, the National Commission on Restructuring the IRS found a direct connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration. The AMT tops our list of complex provisions, but our members cited two more that definitely cause problems each filing season and need your intervention to resolve.

As frontline practitioners, we believe Congress could provide significant relief and make the job of the IRS easier by making immediate changes in three areas. First, Congress needs to repeal the alternative minimum tax for individuals. Second, phase-outs and phase-ins need to be standardized. And finally, it needs to simplify the rules for qualifying for the Earned Income Credit.

There are over twenty commonly encountered aspects of individual returns that require phase-out calculations. To mention a few: limits for deductible IRA contributions,

limitations on the use of education credits, child credits, elderly credits, personal exemptions, itemized deductions, passive activity losses and credits. When taxpayers are told Congress has provided incentives or rate reductions for their benefit, and realize when they actually file their returns that they don't "qualify" for the benefits, they feel deceived.

Each year the IRS lists the top errors in filed returns. Earned Income Credit issues make up almost half their list. Our members concur, and express dismay at the number of taxpayers that come to them asking for their assistance in "working the system" to obtain benefits to which they are not entitled. Our members don't participate in such activities. They are held to strict codes of professional conduct, from our own organization and from the IRS. This is not the case for the vast number of paid-preparers in this country.

These three changes would provide significant relief to taxpayers, as well as allow the IRS to free up resources within the agency for other purposes. In addition to improving tax administration, reducing taxpayer burden by simplifying the tax laws will lower taxpayer frustration and improve voluntary compliance.

Finally, we urge you to consider registration of all commercial tax preparers. This would level the playing field so that return preparers who submit paper returns are held to the same high standards as Electronic Return Originators and as Circular 230 practitioners - Enrolled Agents, CPAs and attorneys.

### **Electronic Filing and the Current Filing Season**

In an effort to make electronic filing "paperless" IRS offered a program that would eliminate the need for taxpayers to send in a signature document through the use of an electronic signature Personal Identification Numbers (PIN). The program is not truly "paperless" since the practitioners that offer this service must retain a signature document and copies of the W-2 forms. However, numerous problems have been experienced this filing season with the PIN. Although most of the issues could be categorized as related to the start-up of the program, many of our members have pointed out that the current requirements for using taxpayer PINs are complicated enough that it is often easier to have taxpayers sign the form 8453 instead. Additionally, some practitioners report that as many as 10 percent of their e-filed returns have been rejected this year because of PIN problems.

A new addition to the individual tax forms this year is the "check the box" limited authorization for paid preparers. We believe this addition will be beneficial for taxpayers and the IRS as their telephone assistants become better informed as to the types of inquiries it is to permit. An important step in streamlining the ability to resolve issues with the largest account management intensive organization in the country, the IRS. This leads into the final point I would like to raise today. Despite the recent reorganization efforts and technology improvements, and sometime because of them, the IRS continues to have severe problems with basic account management. Simple problems with client returns often entails hours or days of senseless struggle to get the right information to right person at the agency. Faxed information is never received.

Phone calls go unanswered. Valuable time is spent on hold waiting to talk to a person at the agency, who then has difficulties resolving problems quickly for lack of training and basic technology tools. The IRS is doing better, but it is a long way from resolving this basic problem first identified by the National Commission on Restructuring the IRS. Congress needs to stay the course with adequate resources for technological enhancements and strong oversight.

I appreciate the Committee giving the National Association of Enrolled Agents the opportunity to talking about the 2001 filing season today. Commissioner Rossotti has a tough job and the organization is generally doing the best it can with the limited resources it has.

Thank you.

April 10, 2001

Ms. Lindy L. Paull  
Chief of Staff  
Joint Committee on Taxation  
1015 Longworth House Office Bldg.  
Washington, D.C. 20515

Dear Ms. Paull:

The AICPA appreciates the opportunity to provide the Joint Committee on Taxation with assistance in regard to the annual joint Congressional review of the Internal Revenue Service Strategic Plan and Budget. We are pleased to provide both general recommendations and responses to the specific questions raised in your letter dated March 22, 2001. We have also attached the AICPA's statement to the Internal Revenue Service Oversight Board given on March 20, 2001 regarding the IRS Strategic Plan and Budget.

#### **General Recommendations for the IRS Strategic Plan and Budget**

The AICPA has long and consistently advocated that IRS funding levels must be maintained at sufficient levels to enable the Service to efficiently and effectively administer the tax laws and collect tax efficiently and effectively. It is vital to our voluntary compliance tax system that the Service have the necessary resources to actively administer and enforce the tax law; otherwise serious damage to the effectiveness of our tax system results.

Adequate funding is particularly important for the IRS to implement the numerous taxpayer rights provisions enacted as part of IRS Restructuring and Reform Act of 1998 ("RRA '98"), and at the same time complete its reorganization and computer system modernization.

Since the enactment of RRA '98, the IRS has initiated comprehensive changes in its structure, manner of operation, and technology. Commissioner Charles Rossotti has done an excellent job in setting the tone for the IRS in terms of implementing these changes and the Service has made impressive strides. However, in order to continue the progress made to date, the IRS must be supplied with the necessary funds to complete this agenda. It is also imperative that, once persuaded to fund the IRS Strategic Plan, Congress remain confident that the long-term results are concomitant with their investment.

#### **Specific Responses to Questions Raised by the Joint Committee on Taxation**

Set forth below are our responses to questions raised by your letter of March 22, 2001. Because the time frame for drafting our comments was rather short, our answers reflect our general impressions regarding the underlying issues raised by the questions. The questions raised in your letter are noted in italics.

1. *RRA '98 contained many provisions that enhance taxpayer rights, including expanding the availability of innocent spouse claims and offers in compromise and providing new taxpayer due process protections in collection, such as pre-lien and pre-levy hearings and court review of such hearings.*

- a. *Are practitioners utilizing the new procedures?*

The AICPA strongly supports the various provisions of RRA '98 designed to enhance taxpayer rights, including expanded availability of innocent spouse relief and offers in compromise, and the new taxpayer due process protections. Based on informal discussions we have had with CPAs, we are finding that the AICPA membership is increasingly using these provisions on behalf of their clients.

Specifically, CPA practitioners are taking advantage of the pre-lien and pre-levy hearing procedures for their clients. However, many practitioners feel compelled to file automatically for a due process hearing, especially after a Notice of Intent to Levy is received. As a result, we understand that collection cases now represent a much larger percentage of the Appeals workload than ever before. While exam activity remains low, Appeals appears able to absorb this additional work. However, when exam activity increases, as the budget and strategic plan envision, we are concerned that Appeals will lack the resources necessary to resolve its collection cases on a timely basis.

Also, it is our impression that AICPA members are attempting to employ the IRC section 6015(f) equitable relief provisions for spouses, but without any measurable results. CPAs appear to find the IRS's interpretation of the equitable relief provisions too stringent. The Joint Committee on Taxation should inquire about the number of cases that have resulted in the IRS granting relief under this new provision.

- b. *Has the IRS been responsive in such actions?*

Although the AICPA is not in a position to validate the current status of a program like the innocent spouse program, it is our impression today that the IRS has generally been responsive to the increase in interest by taxpayers and practitioners to the taxpayer rights provisions of RRA '98. While we realize that there were extensive concerns about the innocent spouse program a year ago, we believe that the IRS's recent efforts in this area have made a difference. In particular, we appreciate the extent to which the IRS is providing further coverage of critical programs through (1) an expansion of the Service's website; (2) implementation of centralized casework centers for review, such as the Cincinnati Service Center for innocent spouse claims; and (3) the release of additional guidance.

The informal feedback we are currently receiving from AICPA members indicates that the IRS has made strides in assuring that services are available to taxpayers. Anecdotal evidence suggests that more open discussions are taking place between IRS Revenue Officers, taxpayers, and their representatives. However, we must note that this improvement has been at the cost of other programs from which personnel have been detailed to work the innocent spouse cases. Again, adequate resources are needed to provide appropriate coverage to all programs.

- c. *Have practitioners observed expanded availability of offers in compromise as provided in the IRS Reform Act?*

Our members are observing that more offers in compromise are being submitted and "processed" than in the past. Unfortunately, many of these CPAs also have the impression that IRS collection personnel have adopted an inappropriately rigid approach in their review of offers in compromise that have been filed, especially when interpreting national and local standards for analyzing "necessary expenses."

In general, the IRS does not appear to be approving offers in compromise based on the "additional basis for compromise" criteria. Under this type of offer in compromise, the IRS is supposed to consider such an offer when the Service determines that the offer promotes effective tax administration based on economic hardship or equity issues. Unfortunately, we are not aware of any taxpayers whose offers in compromise were approved by the IRS based on the "additional basis for compromise" criteria.

2. *In an effort to modernize the IRS by organizing around its customers' needs, the IRS has established four new operating divisions: Wage & Investment, Small Business/Self-Employed ("SB/SE"), Large & Mid-Size Business ("LMSB"), and Tax-Exempt and Government Entities.*

- a. *What changes in practice have been observed as a result of the reorganization?*

The AICPA's members have not had enough practical exposure to date to provide any specific conclusions regarding the results of the reorganization. We do recognize, however, that the IRS reorganization is clearly still in transition with much work yet to be done. Congress should continue to monitor the reorganization as the Service focuses on the many issues that continue to arise as a result of the modernization, and the many transitions still to occur. For example, it is extremely important that the ongoing transition of Service Center workflows appear as seamless as possible to the American taxpaying public.

- b. *Have practitioners been experiencing difficulties in contacting the appropriate office within the IRS? For example, when contacting the IRS, have practitioners been directed to the proper individuals and/or offices within the IRS?*

Numerous AICPA members have experienced difficulties in contacting appropriate offices within the IRS. Many practical questions remain about whom taxpayers should approach for specific types of interactions that previously would have taken place with a District Director, District Counsel or Service Center Director who was responsible for all such matters within a specific geographic area.

- c. *What difficulties, if any, have practitioners observed when clients have issues that involve multiple divisions within the IRS? Are taxpayers required to deal with more than one point of contacting to resolve issues?*

We do not have sufficient feedback from our members regarding the difficulties practitioners may be encountering when trying to resolve an issue on behalf of a client involving multiple divisions of the IRS. However, we have consistently recommended that a special emphasis be placed on the development of clear and effective lines of communication and policy coordination among the four operating divisions, including a mechanism to appropriately and timely resolve the common issues that will inevitably arise as each of the four operating divisions addresses the needs of its customers. Clearly, taxpayers must be treated consistently across the operating division lines.

- d. *Have practitioners experienced improvements in dealing with the IRS as a result of the IRS's reorganization? If so, what improvements have been observed?*

The IRS reorganization has not been in effect long enough, and thus we are not in a position to comment on the issue of whether or not CPAs are experiencing improvements in dealing with the IRS. As we stated above, we do recognize that the IRS reorganization is clearly still in transition with much work yet to be done.

We do believe, however, that the Office of the National Taxpayer Advocate is one area in which practitioners have experienced improvements in their dealing with the IRS as a result of the IRS's reorganization. Since its creation in 1998, the National Taxpayer Advocate's Office has played a critical role in identifying and addressing systemic problems as well as resolving specific taxpayer issues. In the AIPCA's view, future Congressional support for the Advocate will reap tremendous gains in terms of taxpayer confidence and improved tax administration. Furthermore, we believe that the National Taxpayer Advocate's independence can be greatly enhanced and strengthened as a result of Congressional support. In addition, we strongly encourage Congress to carefully review the Taxpayer Advocate's Annual Report. Each year this Report makes

Ms. Lindy L. Paull  
April 10, 2001  
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reasonable, meaningful and important observations and recommendations that should receive more attention than they have in the past both from Congress and outside of the Advocate's office at the IRS.

Finally, we call your attention to the fact that both the LMSB and SB/SE have conducted extensive outreach to outside stakeholders, practitioners and taxpayers alike. We believe that in the long run this outreach will yield tremendous benefits to both the Service and the taxpaying public.

The AICPA would be pleased to discuss this letter, or our March 20, 2001 statement before the IRS Oversight Board, with you, or a member of your staff, at any time. If you have any questions, please contact me at (661) 663-8815 or ppecar@aol.com; Deborah J. Pflieger, Chair of our Relations with IRS Committee at (202) 414-1018 or deborah.j.pflieger@us.pwcglobal.com; or Benson S. Goldstein, AICPA Technical Manager, at (202) 434-9279 or bgoldstein@aicpa.org.

Sincerely,



Pamela J. Pecarich  
Chair  
Tax Executive Committee

**INTERNAL REVENUE SERVICE OVERSIGHT BOARD  
PUBLIC MEETING:  
IRS STRATEGIC PLAN AND BUDGET RECOMMENDATIONS**

**March 20, 2001**

Mr. Chairman and other members of the IRS Oversight Board, the American Institute of Certified Public Accountants thanks you for the opportunity to appear before you today. I am David A. Lifson, immediate past Chair of the AICPA's Tax Executive Committee. Joining me today is Deborah J. Pflieger, Chair of the AICPA's Relations with the IRS Committee. The AICPA is the national, professional organization of certified public accountants comprised of more than 350,000 members. Our members advise clients on Federal, state, local, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, and small and medium-sized businesses, as well as America's largest businesses. It is from this broad base of experience that we offer our comments today.

We are pleased to provide comments regarding: (1) the critical activities the Oversight Board must perform to effectively fulfill its mission, (2) the IRS' Strategic Plan for fiscal years 2000-2005, and (3) the IRS fiscal year 2002 budget.

The AICPA believes that the Oversight Board's first priority should be to hire a qualified, full-time staff. We are encouraged by the pro-active search that the Board is currently conducting for purposes of addressing this staffing matter. As a volunteer organization, the AICPA is extremely dependent upon its professional staff to accomplish its mission. Likewise, in order to ensure that the Oversight Board has the ability to fully exert its independence, the Board must have its own full-time staff. We believe that such staff will provide the Board with continuity as well as the institutional knowledge that will be necessary for it to accomplish its goals. We also believe that such a staff will assist the Board in being a prominent, respected and independent voice for effective IRS management.

**General Recommendations for the IRS Oversight Board's Focus and Attention**

We believe that there are a number of critical activities that the Oversight Board must perform to effectively fulfill its mission.

**IRS Budget.** The AICPA has long advocated that IRS funding levels must be sufficient to enable the Service to efficiently and effectively administer the tax laws and collect tax. We are pleased that one of the Oversight Board's top priorities will be acting as an advocate for the IRS budget since it is vital to our voluntary compliance tax system that the Service have the resources necessary to properly enforce the tax laws. When the IRS is, or appears to be, unable or unwilling to actively administer and enforce the tax law, serious damage to the effectiveness of our tax system results. Therefore, we encourage the Oversight Board to strongly support the IRS' budget needs, and vigorously promote that budget within the Treasury Department, on Capital Hill and in the court of public

opinion. Obviously, we expect the Service to identify rational ways to allocate any additional resources it receives over prior years, and the Oversight Board to ensure that those resources are properly utilized. Finally, we believe the Board should pursue multi-year funding (i.e., budgeting for multiple years at the same time) to ensure stable funding in the future.

**National Taxpayer Advocate.** Likewise, we believe that the Oversight Board must support the Office of the National Taxpayer Advocate to the greatest extent possible. The creation of the Office of the National Taxpayer Advocate has been an important and valuable addition to tax administration in this country. Since its creation in 1998, the National Taxpayer Advocate's Office has played a critical role in identifying and addressing systemic problems as well as resolving specific taxpayer issues. We strongly believe that the Oversight Board's support for the Advocate will reap tremendous gains in terms of taxpayer confidence, improved tax administration and congressional awareness. Furthermore, we believe that the National Taxpayer Advocate's independence can be greatly enhanced and strengthened as a result of this support.

**Tax Law Simplification.** For many years, the AICPA has been outspoken with respect to the need to reduce tax law complexity, especially from the perspective of the administrability of the tax law. Congress seemed to recognize the tax administrability issue when it wrote in section 4021 of the IRS Restructuring and Reform Act of 1998 (RRA '98), which states "It is the sense of Congress that the Internal Revenue Service should provide the Congress with an independent view of tax administration, and that during the legislative process, the tax-writing committees of Congress should hear from front-line technical experts at the Internal Revenue Service with respect to the administrability of pending amendments to the Internal Revenue Code of 1986." While we recognize IRC section 7802 provides that the Oversight Board has no authority or responsibility to develop or formulate tax laws, we do believe that the Oversight Board should forcefully speak out on the administrability of tax legislative proposals, thereby raising further Congress' awareness of the difficult task it imposes on the Service as it continues to enact complex and constantly changing tax laws.

**IRS Strategic Plan.** The Oversight Board must be involved in the development of the IRS' Strategic Plan. We understand that the Board thoroughly reviewed the plan and commented on it, as did the AICPA. Our comments are discussed below. As noted by the Board, "Accomplishing this plan will be a long and difficult process." We believe that just as it was important for the Board to comment on and contribute to the plan, the Board must monitor the Service's execution of the plan, and both commend its successes and identify those areas that need more attention.

#### **Specific Comments on the IRS' Strategic Plan for Fiscal Years 2000-2005**

The AICPA provided Commissioner Rossotti with comments on the IRS' Draft Strategic Plan for Fiscal Years 2000-2005 on December 22, 2000. Several of our comments on the Strategic Plan merit repeating, particularly in the context of the Oversight Board's responsibilities.

We generally agree with the appropriateness of the three strategic goals identified in the Plan: (1) Top Quality Service to Each Taxpayer in Every Interaction; (2) Service to All Taxpayers through Fair and Uniform Application of the Law; and (3) Productivity Through a Quality Work Environment. To achieve these goals we believe that:

- Enforcement is one of the essential components of ensuring compliance and fairness to all taxpayers. In particular, we appreciate the articulation in the plan of the need for enforcement within its broader meaning, e.g., targeted education, improved and expanded information reporting; clearer guidance; and earlier intervention through voluntary agreements, coordinated issue resolution, clearer notices and increased use of telephonic communication. However, we would encourage the Service to reiterate its commitment to the more traditional enforcement activities when necessary. We also believe that the Oversight Board should support and defend the Service's appropriate enforcement of the Internal Revenue Code.
- The IRS must provide effective, clear and timely published guidance to promote a uniform understanding and consistent application of the tax laws. While we do not believe that the Oversight Board should be involved in the daily development of such guidance, we do believe that the Oversight Board should do whatever is possible to encourage and ensure the publication of such guidance. Likewise, we also believe that the Board should object when the IRS has not published needed guidance.
- The recruitment, development and retention of a quality workforce is essential and we commend the Service's recent recruitment of senior executives from outside the Service. In our experience, when these new executives are partnered with executives who have been developed internally and have critical institutional knowledge, effective leadership has been the result. We are also encouraged by the quality of the outside technical experts that are being brought into various positions within the four new operating divisions. We believe that the Oversight Board should continue to encourage the recruitment of senior executives and technical specialists from outside the Service.
- Training of IRS personnel is critical, and we encourage the Oversight Board to ensure that the necessary resources are devoted to the task.
- As additional resources are dedicated to systems modification, the Board should keep in mind that productivity enhancements through technological advancements have largely eluded the IRS over the past decade.

We are concerned that the Strategic Plan has limited discussion of IRS liaison activities with the practitioner community and other outside stakeholders and advisory groups. We view such interactions as a critical element for the Service's future achievements and

urged the Service to formalize, in the Plan, the Service's commitment to these activities. Particularly in this period of such great structural and process change, practitioners offer the Service a ready source of practical experience and insight gained through their encounters with the new IRS structures, people, and procedures. Likewise, we believe that it is critical for the Oversight Board to interact as often as possible with these outside groups.

We also noted that the Plan had a continued, and appropriate, focus on the structural modernization of the IRS. Modernization is clearly still in transition with much work yet to be done. We believe that the Oversight Board should be involved in this continuing reorganization, particularly as the Service focuses on the many issues that continue to arise as a result of the modernization, and the many transitions still to occur. For example, it is extremely important that the ongoing transition of Service Center workflow should appear as seamless as possible to the American taxpaying public. We also believe that special emphasis should be placed on the development of clear and effective lines of communication and policy coordination among the four operating divisions, including a mechanism to appropriately and timely resolve the inevitable common issues that will arise as each of the four operating divisions meets the needs of its customers. Clearly, the Oversight Board must work to ensure that taxpayers are treated consistently across the operating division lines. Furthermore, the IRS must work harder to avoid the confusion taxpayers are experiencing in dealing with the day-to-day ramifications of the reorganization. For example, there are still numerous practical questions arising with respect to who taxpayers should approach for specific types of interactions that previously would have occurred with a District Director, District Counsel or Service Center Director who was responsible for all such matters within a specific geographic area.

Finally, we are concerned about electronic tax administration in general, and electronic filing (ELF) in particular. Although the AICPA has supported and continues to support the IRS' long range goals regarding the conversion of manual processes to electronic format, we have been frustrated in our attempts both to partner with the IRS in promoting ELF to our membership and in explaining to the IRS the effects of the current system limitations on our constituency. In fact, as the Service shifts its focus from the electronic filing of individual returns to the electronic filing of business returns, involving, listening to, and responding to the various stakeholder groups will be all the more critical. Unfortunately, our experience to date as a stakeholder group in this matter has not been positive.

### **IRS' Fiscal Year 2002 Budget**

The AICPA has consistently taken the position that IRS funding must be maintained at sufficient levels to enable the Service to efficiently and effectively administer the tax laws and collect tax. Adequate funding is particularly important as the IRS continues to perform its tax administration and enforcement duties, implement the numerous taxpayer rights provisions enacted as part of RRA '98, and at the same time complete its reorganization and the modernization of its computer systems.

We firmly believe that the Oversight Board's involvement will be crucial to the process of assuring that the IRS receives the proper level of funding for the fiscal year 2002, and the years beyond. The budget request, as prepared by the Commissioner, recommends funding for fiscal year 2002 of approximately \$9.8 billion. While the Office of Management and Budget approved a reduced budget of approximately \$9.4 billion, the Oversight Board has vigorously championed an IRS budget of \$10.26 billion for the year. We applaud the Oversight Board for advocating a larger budget for the Service and are pleased that under the provisions of IRC section 7802, the President is required to forward the Board's budget request to Congress, along with his own. This will ensure that Congress has the opportunity to review the Oversight Board's recommendation.

The AICPA recognizes that the IRS has experienced many difficulties in recent years, and has made a concerted effort to change. We believe that the change process is well under way, and that the movement is in the right direction. However, this change cannot be completed without adequate funding supported by consistent leadership and oversight.

While the merits of the specific dollar amounts and allocations to the Board's budget proposal require knowledge of facts and an analysis beyond the scope of our review, given the insights gained by the day-to-day practical experiences that our members have working with the IRS, we offer the following observations.

- The Oversight Board should monitor the use of funds by the IRS to ensure that any additional funding is responsibly allocated across the four operating divisions. In addition, funding for any additional enforcement initiatives should be distributed in a rational and responsible manner.
- It is our understanding that the Oversight Board's budget includes full funding for the IRS Staffing Tax Administration for Balance and Equity initiative (STABLE), the initiative to increase IRS staffing to the agency's mid-1990s levels. The STABLE initiative is designed to provide the IRS with sufficient funding to hire the additional employees needed to strengthen the tax compliance and customer service functions of the Service. We continue to applaud the STABLE initiative as a means to achieve a balance between taxpayer service and enforcement. We believe both are necessary for effective tax administration.
- Continuing reports about the extremely low audit rates and lack of collection activity by the IRS are widespread. Last month, the IRS released statistics that continue to highlight the "steady erosion" in audit coverage, enforcement, and case closures. Perhaps the Service's extremely low audit rate is the most telling statistic of all – the Service's audit rate dropped to .49 percent in fiscal year 2000, down from a rate of approximately 1.68 percent in 1995. These dismal statistics cannot begin to be reversed until the IRS has adequate funding for staff. It is vital to our voluntary compliance tax system that this reduction of audit and collection activity be reversed immediately, and that the

resulting increase in enforcement be widely publicized. If the IRS is unable to actively administer and enforce the tax law, serious damage to the effectiveness of our tax system results. Those who normally flaunt the law will continue to do so at no risk; those who in the past have reluctantly complied only because of a fear of enforcement may become noncompliant; and, normally compliant taxpayers will lose faith in the system and may be tempted to become noncompliant as well. For our voluntary tax compliance system to operate effectively, taxpayers must perceive that everyone pays their fair share, and that if they do not do so voluntarily, they will be forced to do so by the IRS.

- As discussed in the IRS' Strategic Plan, an emphasis must also be placed on the training and education of IRS personnel. Some of the most frustrating experiences realized by taxpayers and tax practitioners in dealing with the IRS occur because of a lack of training on the part of the IRS employees involved. It is much easier to work out a solution that is fair to both the tax system and the taxpayer if the individuals resolving the issue are knowledgeable and well trained. Given the "taxpayer segmented" nature of the new organization, it is more important than ever that IRS personnel acquire technical skills and insight that correspond to the needs and issues of their separate taxpayer constituencies. We urge the Board to seek the funds necessary for proper training of the Service's entire work force.
- Another area of concern is the need for adequate funding for appropriate electronic communication. The AICPA fully supports the availability of electronic communication between the IRS, taxpayers, and tax practitioners.

Since the enactment of RRA '98, the IRS has initiated comprehensive changes in its structure, manner of operation, and technology. Commissioner Rossotti has done an excellent job in setting the tone for the IRS in terms of implementing these changes and the Service has made impressive strides. However, in order to continue the progress made to date, we believe that Congress must provide the IRS with the necessary funds to accomplish its agenda. We encourage the Board to continue its fight for a full and reasonable budget for the Service and note that it is imperative in the long-term that, once persuaded to fund the IRS Strategic Plan, Congress remains confident that the results are concomitant with their investment. We are most willing to do whatever we can to assist you in this effort.

### **Conclusion**

The AICPA is encouraged by today's public meeting of the IRS Oversight Board. We pledge our strong commitment to work closely with the Board and the IRS towards implementation of the IRS Strategic Plan and in obtaining proper funding for the IRS for the coming years. We are optimistic that, with appropriate plans and funding levels in place, the IRS can achieve an appropriate balance between taxpayer service and enforcement.

It is our hope that this public meeting will serve as a catalyst for attaining Congressional support for adequately funding the IRS's day-to-day operations as well as its organizational restructuring and technology modernization. Congress instituted the massive and much-needed reforms in the IRS; it is crucial that it now support their implementation.

We appreciate this opportunity to offer our comments to you and would be happy to discuss any of these matters in further detail with the members of the IRS Oversight Board.

APR 25 2001



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April 24, 2001

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Ms. Lindy L. Paull  
Chief of Staff  
Joint Committee on Taxation  
United States Congress  
Washington, D.C. 20515

Dear Ms. Paull:

The Section of Taxation of the American Bar Association (the "ABA Tax Section") appreciates your invitation to provide assistance to the Joint Committee on Taxation in connection with the annual joint Congressional review of the strategic plan and budget of the Internal Revenue Service (the "IRS"). Set forth below is a summary of the general comments previously made by the ABA Tax Section concerning the strategic plan of the IRS, as well as responses to the specific questions posed in your letter dated March 22, 2001. The following comments and responses, which are submitted on behalf of the ABA Tax Section, have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

As you know, the ABA Tax Section is the national voice of the country's tax lawyers, representing about 19,000 members who are in private tax practice, businesses, charities, academia, and the public sector. We have extensive cumulative experience with the IRS at all levels, in all geographic areas, and in all subject matters under the Internal Revenue Code. One of our primary goals is to serve as counsel to the tax system, working to make our system fairer, simpler, and easier to administer.

**General Comments Concerning the Strategic Plan and Budget**

In general, we are strong supporters of the measures set forth in the Strategic Plan for 2000-2005 to transform the IRS into an efficient, modern, and responsive agency. We endorse the overriding goal of making it easier for taxpayers to comply with their responsibilities, while at the same time increasing all taxpayers' confidence that the taxes imposed by our laws are being collected fairly and efficiently. We have previously commended the Service for issuing this Strategic Plan, and we are pleased to be able to repeat that commendation here.

We also agree that the Strategic Plan correctly identifies two external factors that have a significant impact on the ability of the IRS to accomplish the goals identified in the Strategic Plan. The first external factor that hinders the ability of the IRS to restructure is the frequency of complex changes to the Internal Revenue Code. Understandable rules and

procedures, which can be followed by taxpayers and the IRS alike, cannot be expected to flow from a frequently changing tax law. It has become increasingly clear that American taxpayers no longer possess the ability to fully understand and comply with much of the complexity of the tax law, at least not without the expenditure of significant resources for expert help. This situation reduces compliance levels, increases the cost and complexity of the Service's job in administering the tax system, and undermines the public's confidence in their government.

The second external factor that hinders efforts to restructure the Service relates to the annual budget process. We have long advocated multi-year funding of the Service's requirements for modernization, and we intend to continue to advocate adequate funding for the Service in the current budget process, particularly with respect to technology improvements and increasing the number and capabilities of IRS personnel.

While we generally support the strategies identified in the Strategic Plan, we would like to single out three areas for particular emphasis.

First, we agree that it is critical for the Service to develop reliable, up-to-date, cost-effective measures of compliance. We are concerned that the lack of such reliable measures could lead to a misallocation of compliance resources. We have urged the development of such measures in conjunction with an increase in audit activity by the Service.

Second, we believe that it is imperative that the IRS be able to recruit, develop, and retain, a quality workforce. In addition to increasing budgets for personnel, we urge the IRS to take maximum advantage of the pay-scale flexibility provided for by the Restructuring and Reform Act of 1998 ("RRA '98").

Third, we commend the effort of the IRS to focus information technology investments in a manner that will enable the IRS to efficiently and effectively accomplish its mission. There are areas in which we believe that audit activity should be increased, and we will support efforts reasonably calculated to assure taxpayers that the laws are fully and fairly administered. At the same time, we understand that compliance improvements can be achieved efficiently through technological advances that reduce the need for traditional audit resources. In this regard, we strongly support the IRS' programs to improve compliance through return matching and other similar techniques, which play an increasingly integral role in the operation of our voluntary compliance system.

### **Responses to Specific Questions**

The specific questions raised by your letter and our responses are set forth below.

1. *RRA '98 contained many provisions that enhance taxpayer rights, including expanding the availability of innocent spouse claims and offers in compromise and providing new taxpayer due process protections in collection, such as pre-lien and pre-levy hearings and court review of such hearings.*

- a. *Are practitioners utilizing the new procedures? If yes, to what extent are they utilizing them?*

#### Innocent spouse relief

As you are aware, innocent spouse relief under former section 6013(e) often was difficult to obtain. In order to make innocent spouse relief more accessible, Congress repealed section 6013(e) and enacted a new innocent spouse provision (section 6015) as part of RRA '98. Section 6015 provides three avenues for relief from joint and several liability: (1) section 6015(b)(1) (which is similar to former section 6013(e)) allows a spouse to completely escape joint and several liability for an understatement of tax; (2) sections 6015(b)(2) and 6015(c) allow a spouse to partially escape liability to the extent that the spouse did not know (and had no reason to know) that there was an understatement of tax, or to the extent that the taxpayers are no longer married (or are legally separated or not living together) and the items giving rise to the understatement of tax would have been allocated to the other spouse if separate returns had been filed for the year in question; and (3) section 6015(f) allows the IRS to grant equitable relief in situations where relief is not available under either section 6015(b) or section 6015(c).

Based upon practitioner comments, as well as the number of innocent spouse cases filed with the IRS during the past two years, we believe that practitioners are utilizing the new innocent spouse provisions and that such provisions generally are working as intended. We have been told that a significant number of requests for partial innocent spouse relief have been filed under sections 6015(b)(2) and 6015(c), and that an even greater number of requests for equitable relief for spouses have been filed under section 6015(f). The experience of some practitioners, however, is that some IRS personnel may be reluctant to grant requests for equitable relief under section 6015(f). Apparently some IRS personnel are placing a heavy burden on spouses to show that they did not have knowledge or reason to know of an underpayment of tax as a condition of their being granted equitable relief. In addition, some practitioners have expressed concerns about the length of time to process and resolve requests for innocent spouse relief, which can cause adverse consequences to taxpayers from the mere delay alone (e.g., where a spouse facing a notice of a tax lien is prevented from obtaining financing). Some practitioners also have noted the difficulty of ensuring that the full facts of a matter are considered by the IRS, particularly when a low-income taxpayer is not represented by counsel and the IRS relies solely on correspondence to handle a request for innocent spouse relief.

#### Offers in compromise

Prior to the RRA '98, the IRS was permitted to compromise a taxpayer's tax liability on grounds of doubt as to liability for the amount owed or doubt as to the taxpayer's ability to pay the amount owed. The Conference Agreement to the RRA '98 contemplated that the IRS also will consider factors such as equity, economic hardship, and public policy when determining whether to accept an offer in compromise. While we understand that practitioners have seen an increase in the utilization of the offers-in-compromise procedures, these practitioners have not seen an expansion in the offers in compromise accepted by the IRS. Practitioners have advised us that IRS reviewers of offers in compromise often question the existence of financial hardship and rarely, if ever, find that equitable grounds exist for accepting an offer in compromise. Also, as with requests for

innocent spouse relief, some practitioners have complained about the inordinate length of time for the IRS to process some offers in compromise. Some practitioners report their recent experiences that offers-in-compromise usually take at least a year to get through the initial review process.

#### Collection due process

We understand that practitioners are utilizing the new taxpayer due process protections and that, on the whole, the protections are working as intended by Congress. In fact, practitioners have reported that receipt by taxpayers of the collection due process notice itself often has a positive effect by getting the taxpayer's attention, sometimes leading to the use of collection alternatives such as installment agreements and offers in compromise. We have heard reports, however, that some taxpayers have automatically requested due process hearings after receipt of a Notice of Intent to Levy, sometimes for the sole reason to further delay the collection process. The filing of such clearly non-meritorious requests for collection due process hearings eventually contributes to the delays in Appeals workload. Therefore, a mechanism should be developed for speedy dismissal of those claims that are truly frivolous (such as constitutional challenges made by tax protestors). This would be consistent with the legislative history to the RRA '98 regarding suspension of collection while an offer in compromise is pending (see H. Rpt. 105-599 at 288) and would help to ensure that scarce resources are not diverted from meritorious collection due process hearings.

- b. *Has the IRS been responsive in such actions? For example, have pre-lien or pre-levy hearings been effective.*

Practitioners continue to express concern over the length of time to resolve an innocent spouse case with the IRS, to complete the offer-in-compromise process, or to convene a collection due process hearing. As noted above, we believe the IRS needs adequate funding to ensure that these programs work as Congress envisioned when enacting the RRA '98, so that taxpayers may come into compliance with their Federal tax responsibilities. Adequate funding of these taxpayer-rights programs should not be to the detriment of other IRS programs, nor cause additional decreases in the already low audit coverage rates.

- c. *Have practitioners observed expanded availability of offers in compromise as provided in the IRS Reform Act? For example, has the IRS in practice been considering factors other than doubt as to liability or collectibility, such as equity or hardship, in determining whether to compromise a tax liability?*

To date, our informal feedback suggests that most practitioners have not observed an expanded availability of offers in compromise. Our impression is that many IRS personal continue to accept or reject offers in compromise based upon the doubt as to liability and/or doubt as to collectibility standards and are not approving offers based upon economic hardship or equitable grounds. In this regard, some practitioners believe that the temporary regulations promulgated under section 7122 contain examples that are too narrowly drawn because of the emphasis placed on medical disability in determining whether collection of the full liability would create economic hardship (see Treas. Reg. Sec. 301.7122-1T(b)(4)(iv)(D)), while others believe that the regulations are being too narrowly

construed. In either event, changes in the offers-in-compromise program are needed in order to satisfy the congressional mandate expressed in the Conference Agreement to RRA '98, which stated that "the conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system." (H. Rpt. 105-599 at 289)

2. *In an effort to modernize the IRS by organizing around its customers' needs, the IRS has established four new operating divisions: Wage & Investment, Small Business/Self-Employed, Large & Mid-Size Business, and Tax-Exempt and Government Entities.*

a. *What changes in practice have been observed as a result of the reorganization?*

Because the reorganization of the IRS is still relatively new, the ABA Tax Section is not in a position to provide specific conclusions concerning changes in practice brought about by the new operating divisions. Overall, we believe that the IRS is on "the right track" in its new operating divisions. We also have found the leadership of these new divisions to be very open and responsive, which makes it much easier for the Tax Section to communicate with these new divisions at a leadership level.

As to specific changes in practice arising from the reorganization, our informal feedback suggests that IRS personnel are still learning chains of authority and lines of communication, so implementation of any formal changes in practice have yet to be seen by a large cross section of practitioners. Clearly, the reorganization is not complete, and we recognize that the IRS is still fine-tuning the reorganization process. We believe that the right messages are being communicated to the IRS personnel in the field, but we will need to wait and see what the impact is on the practices of IRS personnel.

One shift in IRS practice in the Large and Mid-size Business Division ("LMSB") operating division that practitioners believe could lead to positive results is the emphasis placed on prefiling activity. A practice of resolving disputes prior to the filing of tax returns could potentially save both taxpayers and the IRS significant amounts of resources. Moreover, the sense among many practitioners is that the senior IRS LSMB executives are committed to working with taxpayers to make audits more current and to resolve issues without litigation. Practitioners eagerly await the implementation of this practice

b. *Have practitioners been experiencing difficulties in contacting the appropriate office within the IRS? For example, when contacting the IRS, have practitioners been directed to the proper individuals and/or offices within the IRS?*

Many practitioners have experienced difficulties in determining the appropriate office within the IRS and the appropriate supervisors to contact. The LMSB operating division is illustrative of the difficulties encountered by practitioners. A taxpayer within the jurisdiction of the LMSB operating division will need to contact IRS personnel within the taxpayer's particular industry group. The practitioner must first determine into which of the five industry groups the client has been placed by the IRS. To date, the IRS has not

published any guidance that would clearly identify a taxpayer's specific industry group. The problem is further compounded by the fact that the IRS continues to realign industry groups by moving segments of taxpayers from one industry to another. For example, the IRS recently announced that construction companies will be shifted into the natural resource industry group, while for-profit health care entities will be moved from the financial resources industry group to the retail, food and pharmaceutical industry group. Once the practitioner determines the industry group within which the taxpayer has been placed, the practitioner must then understand the geographic structure that is unique to that specific industry group to determine the appropriate persons to contact. Developing updated guidance to assist taxpayers and practitioners in contacting the appropriate office within the restructured IRS would be beneficial.

*c. What difficulties, if any, have practitioners observed when clients have issues that involve multiple divisions with the IRS? Are taxpayers required to deal with more than one point of contacting to resolve issues?*

We have not received sufficient feedback from practitioners regarding difficulties clients are encountering on issues that involve multiple divisions within the IRS in order to comment on this issue. One area of concern among practitioners is the possible inconsistent treatment of taxpayers in different operating divisions with similar issues. For taxpayers subject to the LMSB operating division, this concern arises because there are five industry groups within the LMSB operating division and each of the five industry groups employs industry specialists and counsel attorneys. The possibility exists for a lack of uniformity in the treatment of similarly situated taxpayers when each industry separately resolves issues common to taxpayers across all industry groups. In particular, care should be given to minimize the potential that a "split of opinion" could develop between IRS industry specialists assigned to particular industry groups and counsel who remain part of the Chief Counsel's National Office staff. (For example, prior to the reorganization, some practitioners who worked in the exempt organization area complained of such "splits of opinion" between the Commissioner-side technical staff and Chief Counsel attorneys.) Clearly, it is to the benefit of both taxpayers and the IRS that effective procedures be developed and implemented to ensure timely communication and policy coordination among the four new operating divisions and the various industry groups within those operating divisions.

*d. Have practitioners experienced improvements in dealing with the IRS as a result of the IRS's reorganization? If so, what improvements have been observed?*

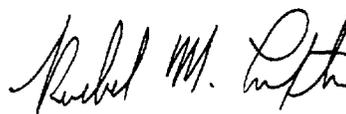
Because the IRS reorganization is still in the early stages of its implementation, we do not have enough information to determine whether practitioners are experiencing any patterns of improvements as a result of the reorganization. We are encouraged by the new initiatives announced by the Large and Mid-size Business operating division to resolve disputes with taxpayers, such as the pre-filing agreement program, the industry issue resolution program, and the comprehensive case resolution program, and eagerly await feedback from practitioners on the effectiveness of these programs. We are also encouraged by the recent efforts of the IRS to utilize alternative dispute resolutions such as mediation and arbitration when the regular Appeals procedures fail to resolve a matter.

\* \* \* \* \*

Your letter raised numerous specific questions that we have attempted to answer. The one thing that is missing from your questions is our overall impression of the manner in which the IRS is implementing its reorganization under RRA '98. We want to emphasize our strong support for the reorganization, our belief that the IRS is moving in the right direction and our understanding that the leadership of the IRS is implementing the reorganization as quickly as is feasible. They have our strong support in their endeavors.

As members of the ABA Tax Section gain more experience with the taxpayer rights provisions under RRA '98 and with the IRS reorganization, we look forward to continuing to provide additional feedback to Congress for its oversight of these important matters.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Richard M. Lipton".

Richard M. Lipton  
Chair, Section of Taxation

# Tax Executives Institute, Inc.

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April 12, 2001

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Lindy Paull

Chief of Staff

Joint Committee on Taxation

1015 Longworth House Office Building

Washington, D.C. 20515

Re: **Report on IRS Strategic Plan and Budget**

Dear Ms. Paull:

In response to your recent request, I am pleased to submit the following comments in respect of the annual joint congressional review of the strategic plan and budget of the Internal Revenue Service.

## BACKGROUND

Tax Executives Institute is the preeminent association of business tax executives in North America. Our approximately 5,300 members represent 2,800 of the leading corporations through 53 chapters in the United States, Canada, and Europe. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works — one that is administrable and that taxpayers can comply with in a cost-efficient manner.

Members of TEI are responsible for managing the tax affairs of their companies and must contend daily with the Internal Revenue Service and provisions of the tax law relating to the operation of business enterprises. We believe that the diversity and professional training of our members enable us to bring an important, balanced, and practical perspective to the review of the IRS's strategic plan and budget for the fiscal year 2002.

The joint congressional review focuses on the IRS's long-term objectives, the steps the agency has taken to achieve these objectives, and the extent to which the Administration's budget submission for the IRS supports these objectives. Specifically, the Joint Committee on Taxation invited TEI's comments on the following questions:

- What changes in practice have been observed as a result of the IRS's reorganization into four operating divisions?
- Have TEI's members experienced difficulty in contacting the appropriate office within the IRS?
- What difficulties, if any, have members observed when issues involve multiple divisions of the IRS? Are taxpayers required to deal with more than one point of contact to resolve issues?
- Have members experienced improvements in dealing with the IRS as a result of the IRS's reorganization? If so, what improvements have been observed?

#### **EFFECT OF THE IRS REORGANIZATION**

The companies that employ TEI's members have almost without exception been assigned to the IRS's Large and Mid-Size Business Division (LMSB) and, prior to the reorganization, were part of the Coordinated Examination Program (CEP), pursuant to which they were subject to continual audit. (Under LMSB, these largest 1,500 taxpayers are subject to ongoing audits as part of the Coordinated Industry Cases (CIC) program.) TEI's perspective, therefore, is unique. Whereas the effect of the IRS reorganization on taxpayers in some sectors may be more focused on enforcement efforts (and, pursuant to the strategic plan, more audits), for TEI's constituency the organization promises more effective and efficient examinations, as well as a more pronounced customer-service orientation.

TEI is pleased to have worked with the IRS Restructuring Commission, the agency itself, and (since its formation) the LMSB Division to improve tax administration. The organization has worked closely with the IRS to help make its restructuring efforts a success. Our members and staff have participated in numerous projects with the IRS, have met with myriad modernization design teams to promote or comment on suggested improvements, and have fully embraced the concept of working together as a full partner in tax administration. For example, the IRS and TEI have designated points of contacts for each industry group and each TEI chapter and region to improve liaison efforts. More contacts within each level of LMSB can only help the process.

A key feature of the IRS reorganization is moving from a "back-loaded" (post-filing) to a "front-loaded" (pre-filing) system and thereby removing the "archeological dig" aspect of examinations. TEI supports the increased attention paid to "front-end" activities promised by the IRS's strategic plan, as well as its emphasis on resolving issues on an industry basis. Enhancing

taxpayer education and providing taxpayers and IRS personnel with clearer, quicker guidance will make it easier for taxpayers to comply with the laws and reduce taxpayer burden. The Institute also supports the agency's efforts (primarily through the Taxpayer Advocate) to identify excessively complex tax provisions and to recommend simplifying changes. We also applaud the proposed renewed focus on enforcement activities, especially in respect of underreporting, nonfiling, and abusive trusts and pass-through entities, as well as other areas that may have been slighted in the past. And we applaud the IRS's commitment to strengthening its ability to deal effectively with the global economy.

That is not to say that TEI's members do not experience difficulties in dealing with "the new IRS." The LMSB Division has undertaken several initiatives — such as the pre-filing agreement program and the industry issue resolution pilot — that hold great promise for changing the focus of the agency. To move to a focus on pre-filing activities, however, there must be an improvement in the currency of IRS audits. The IRS must ensure that the use of resources in pre-filing activities does not by itself increase the audit time for LMSB taxpayers. In addition, field agents must be trained in ADR techniques. Finally, addition, care must be taken to preserve the confidentiality of taxpayer information submitted in a pre-filing regime.

Moreover, there may be a need for LMSB to interact with other divisions such as the Small Business/Self-Employed Division. To date, there are questions about the operation of cross-divisional councils, on both management and guidance issues. For example, the decision (since delayed) to revise the Form W-2 to require the separate reporting of stock options could have created significant compliance burdens for employers, who were initially given less than two months in which to reconfigure their systems to comply with the new reporting requirements. Given the policy and administrative issues underlying that decision (and in light of the controversy that ensued), more involvement across division lines — coupled perhaps with IRS's outreach to TEI and other groups in the employer community — would seem prudent.

Finally, the Institute is concerned that the IRS receives the funding it needs to reach its goal of improved taxpayer service and focus on compliance activities. For example, our members are concerned about the agency's ability to recruit, train, and retain qualified personnel. TEI is also concerned about the acquisition, installation, and effective utilization of state-of-the-art technology. Whether the promise of the reorganization can be realized depends in large measure on the IRS securing sufficient funds to do its job.

## **THE NEED FOR ADEQUATE FUNDING**

TEI has consistently supported adequate funding for the Internal Revenue Service. If Commissioner Rossotti and the other leaders of the IRS are to rebuild the agency's credibility and effectiveness, the agency must be assured that the programs needed to implement its mission will be fully and consistently funded. The IRS is at a critical juncture in its restructuring efforts. To succeed in reinventing itself as a modern, taxpayer-focused agency, the agency must have adequate funding for its service initiatives.

More specifically, TEI believes that the IRS's modernization efforts and staffing plans must be fully supported in order to ensure a proper balance of the IRS's taxpayer service, enforcement, modernization, and other activities. Although TEI has not undertaken a review of the proposed budget's myriad details, we do support the principles underlying the Staffing Tax Administration for Balance and Equity (STABLE) initiative (whereby the IRS will add a total of 4,000 staff), as well as the proposed "replenishment" of the Information Technology Assessment Account. We also support providing additional funds for training and travel, thereby supporting the organizational changes that undergird the restructured agency.

## CONCLUSION

Assessing the Internal Revenue Service's progress since enactment of the 1998 Restructuring Act, TEI is impressed with the agency's efforts to remake itself. We sense a renewed energy and commitment in the agency's leadership corps and remain hopeful that the promise of restructuring will be realized. To be sure, TEI has concerns about certain aspects of the IRS's day-to-day operations, but the IRS's recent strategic plan and its linkage to its budget confirms that the agency is focusing on the right issues. Much progress has been made, and much remains to be done. TEI looks forward to working with the Joint Committee and the IRS itself to improve tax administration.

If you have any questions, please feel free to contact me 702.891.3409 or the Institute's General Counsel, Timothy J. McCormally, at 202.638.5601.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.



Betty M. Wilson  
*International President*



U.S. Department of Justice  
Office of Legislative Affairs

APR 19 2001

Office of the Assistant Attorney General

Washington, D.C. 20530

APR 13 2001

Lindy L. Paull, Esquire  
Chief of Staff  
Congress of the United States  
Joint Committee on Taxation  
Washington, DC 20515-6453

Dear Ms. Paull:

We are pleased to respond to your letter of March 22, 2001, to the Tax Division. In the letter, you ask for answers to questions arising in connection with your review under section 8021(f) of the Internal Revenue Code of 1986. The questions and our responses follow:

**1. Has the Justice Department (DOJ) observed a decline in the number of IRS referrals since enactment of the Restructuring and Reform Act of 1998 (RRA 98)? If so, how much of a decline has been observed? In addition, to what would DOJ attribute any observed decline?**

RESPONSE:

The Department has observed a decline in the number of IRS referrals both in civil and criminal cases since the enactment of RRA 98. The decline in referrals of some categories of civil cases from FY 1998 to FY 2000 has been significant, including referrals of bankruptcy and other collection-related matters, tax refund suits filed by taxpayers, and tort/damage actions against the United States and against IRS and other government employees. We have also noted a decline in the number of criminal referrals over these years. IRS compliance actions generate civil litigation handled by the Tax Division and develop leads to possible criminal violations. Thus, the decline in our civil and criminal case numbers is doubtless caused in large measure by the acknowledged curtailment of IRS compliance actions. See **IRS Strategic Plan (Fiscal Years 2000 -- 2005)** at 30-31, 57 (discussing declines in compliance enforcement and the perceived causes of the declines).

Civil cases. A significant portion of the Tax Division's civil referrals are comprised of bankruptcy and other collection-related matters such as suits to foreclose IRS tax liens, interpleader actions, wrongful levy claims by taxpayers, failure to honor IRS levy cases, and fraudulent transfer actions. IRS has scaled back its administrative collection efforts in the wake of RRA 98. The reduced collection activity is reflected dramatically in the statistics measuring notices of federal tax lien, levies, and property seizures. Administrative collection activity generates bankruptcies and other collection-

related litigation handled by the Department. Accordingly, the curtailed collection activity is likely the most significant cause of the decline in bankruptcy<sup>1</sup> and other collection-related referrals received by the Department. Another factor is the expansion of administrative appeal rights for taxpayers, such as the collection due process rights enacted by RRA 98. These procedures slow the collection process and require the diversion of resources to their handling. The acceptance rate of installment payment agreements and offers in compromise may also be a factor as any increase in the settlement rate at the administrative level naturally reduces the number of controversies that reach the courts.

We have experienced a general decline in refund suit referrals for the last several years, starting before enactment of RRA 98. While there may be a variety of reasons for the decline, the IRS audit rate is likely the most significant contributor. RRA 98 is probably not a factor except to the extent that it may have contributed to a reduction in refund suits challenging IRS assessments of section 6672 penalties – cases where an individual taxpayer is held personally liable for the unpaid trust fund taxes of a corporation – which may be attributable to the collection-related factors discussed above.

The decline in tort and damage suits filed by taxpayers against the United States and IRS and other government employees may also be attributed to the decline in enforcement actions taken by the IRS.

Criminal cases. We have experienced a decline in criminal case referrals since enactment of RRA 98. The downturn in the number of civil audits is an important factor. In our experience, the IRS audit process is the best source of referrals to IRS Criminal Investigation of legal-income criminal cases, but the level of traditional examination activity has declined in recent years. *See IRS Strategic Plan (Fiscal Years 2000 -- 2005)* at 57. We also believe that the retirement of a number of Internal Revenue Service special agents over the last several years has had an impact on the number of criminal case referrals and the reorganization of Internal Revenue Service Criminal Investigation, including consolidation of its field offices, has undoubtedly impacted its output. It is too early to judge, however, the full effect of RRA on criminal tax referrals because it generally takes years to develop these cases in light of their complexity.

**2. In your opinion, has RRA 98 affected the workload and/or the nature or quality of the cases handled by the U.S. Attorney offices or the quality of assistance from the IRS?**

RESPONSE:

Civil cases. The Tax Division handles the vast majority of all substantive civil tax matters, except for tax litigation that occurs in the United States Attorney's offices in the Southern District of New York, the Central District of California, and the Northern District of California. The civil tax

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<sup>1</sup> Some of the decline in bankruptcy cases is likely due to a general decline in bankruptcy filings in the last three years. According to figures provided by the Administrative Office of the United States Courts, new bankruptcy case filings fell by 12 percent from FY 1998 to FY 2000.

litigation handled by the other United States Attorneys generally is bankruptcy litigation involving non-substantive tax or factual issues, and summons enforcement litigation. The effect of RRA 98 on bankruptcy litigation handled by the United States Attorneys Offices would be similar to that experienced in the Tax Division. The decrease in collection and audit activity would also result in a decrease in summons enforcement litigation. We have ascertained no difference in the overall quality of assistance from the IRS. While we have not been able to survey in the time available the United States Attorneys, we assume that the quality of assistance is similar to that experienced by the Tax Division.

Criminal cases. The Tax Division authorizes the prosecution of criminal tax cases. Based upon our review of cases during the authorization process, there has not been any change in the caliber of the IRS's criminal investigations since enactment of RRA 98, or any effect on the quality of the criminal tax cases referred to the Tax Division for authorization of prosecution. We also perceive no change in the quality of the assistance rendered by the IRS to the United States Attorneys or to the Tax Division. As to the nature of the cases being investigated, it appears that IRS Criminal Investigation is concentrating its efforts more on tax matters involving legal-source income. This renewed focus doubtless results from the recommendations of the Webster Commission, not RRA 98—which did not deal directly with this issue.

**3. Since RRA 98 was enacted, has DOJ observed any changes in the amount or quality of communications (formal or informal) with the IRS? If so, please describe in detail how such communications have changed.**

**4. Since the reorganization of the IRS and Chief Counsel, has DOJ observed any changes in the amount or quality of communications (formal or informal) with the IRS? If so, please describe in detail how such communications have changed.**

RESPONSE:

We have observed very few changes in the quality of communications with the IRS since the enactment of RRA 98 or since the reorganizations of the IRS and the Office of Chief Counsel. Moreover, the volume of these communications is consistent with the reduced number of civil and criminal referrals. The Service has been very cooperative in assisting us in learning the new structure and in putting us in touch with the appropriate employees to assist us in our work.

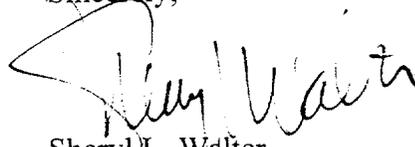
While there are isolated civil cases where there has been confusion over who in the Office of Chief Counsel should be contacted on a particular issue, those problems are almost always resolved to our satisfaction. Moreover, the quality of the assistance provided has remained at the same high level we have come to expect from the Office of Chief Counsel.

Immediately following the reorganization some minor issues also arose in a few criminal cases, for example, with IRS Criminal Investigation not following the revised procedures in forwarding tax matters to the Tax Division. These problems, however, have subsided as everyone has adjusted to the

reorganization and the changed procedures. Overall, we believe that the quality of the communications with the IRS has remained unchanged.

We hope that these responses will be helpful to you in your review. If we may provide additional assistance, please let us know.

Sincerely,

A handwritten signature in black ink, appearing to read "Sheryl L. Walter". The signature is written in a cursive style with a large, sweeping initial "S".

Sheryl L. Walter

Acting Assistant Attorney General

UNITED STATES TAX COURT

WASHINGTON, DC 20217

CHAMBERS OF  
THOMAS B. WELLS  
CHIEF JUDGE

APR 09 2001

April 3, 2001

Lindy L. Paull, Esq.  
Chief of Staff  
Congress of the United States  
Joint Committee on Taxation  
Washington, D.C. 20515-6453

Dear Ms. Paull:

Thank you for your letter dated March 22, 2001. We are pleased to have the opportunity to respond to your questions regarding the effect of the I.R.S. Restructuring and Reform Act of 1998 (I.R.S. Reform Act) on the operations of the United States Tax Court. We have the following responses to your questions (the responses are numbered in the same order as your questions):

1. a. As of February 28, the number of pending cases in the jurisdictional areas set forth in your letter are as follows:

- (1) Relief under 26 U.S.C. 6015(e): 191 cases
- (2) Liens/Levies: 250 cases
- (3) Employment Taxes: 47 cases
- (4) Declaratory judgment: 0 cases

There has been no significant change in the Court's workload due to the I.R.S. Reform Act thus far, although the Court has endeavored in its recent opinions to provide early guidance as to these new jurisdictional areas.

b. There has been no significant change in the nature or type of cases in the Court's workload due to the I.R.S. Reform Act.

2. The Court has no independent way to ascertain whether a decline in the number of new cases filed is attributable to fewer audits or for other reasons.

3. a. The Court has not experienced any significant changes in I.R.S. Counsel's management of cases in the Court.

b. The Court has not observed any other significant changes in I.R.S. Counsels' representation of the Commissioner of the Internal Revenue Service before the Court.

Thank you for giving us the opportunity to respond to your questions. If you have any additional questions or require any clarification of these responses, please do not hesitate to call me at (202) 606-8700.

Sincerely,

A handwritten signature in cursive script, appearing to read "Thomas B. Wells", with a long horizontal flourish extending to the right.

Thomas B. Wells  
Chief Judge



COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Ms. Lindy L. Paull  
Chief of Staff  
Joint Committee on Taxation  
U.S. House of Representatives  
Washington, D.C. 20515-6453

APR 27 2001

Dear Ms. Paull:

I am writing in response to your letter dated March 7, 2001, in which you requested information from the IRS to help prepare for the upcoming annual joint congressional review of our strategic plans and budget. Attached are our responses to the questions you submitted.

The IRS strategic plan supports and adds detail to the overall strategic plan of the Department of the Treasury submitted to Congress in September of last year. Copies of the final plan were distributed and are currently posted on the IRS web site.

I hope this information is helpful. If I can provide you with any additional information, please let me know.

Sincerely,

Charles O. Rossotti

## 1. Modernization

### 1(a) Each division of the IRS has its own initiatives.

#### 1(a)(1) Is there any interaction between the divisions such that efforts are coordinated for modernization? If so, how are the divisions working together in modernizing the IRS?

Extensive interaction occurs among the operating divisions to ensure coordinated efforts for modernization, with an especially vigorous interaction at work in the IRS' strategic planning and budgeting process. This process gives the top leadership of the IRS a forum for a structured, collaborative dialogue aimed at both defining future IRS strategies and priorities, and allocating resources. The process begins with a strategic assessment in which the heads of the operating divisions identify problems, trends and issues. Using these building blocks, we then collectively construct major strategies, operational priorities, and improvement projects. The identification of cross-divisional issues is an important part of the process, and we designated business division owners and partners for every priority and improvement initiative. We are beginning our second year under the new strategic planning and budgeting process, and have found it fosters close communication and coordination among the divisions, and promotes progressively tighter linkages between planning and budgeting.

The integrative mechanisms that are necessary for a successful planning process are also essential for day-to-day operations. In designing our new organization, we built our line structure around servicing groups of like taxpayers -- like many private sector firms, we decided the organizational dimension that mattered most was customer segments. However, we recognized there were also other important dimensions and that many problems have multiple dimensions.

Clearly geography is one dimension that needs coordination and proper emphasis. The IRS has long had a strong geographical identify at the local level and we believe we need a well-planned way of managing through this change. We are using designated "Commissioner's Representatives" to help deal with both internal administrative issues and external representation to practitioners and the local community. Additionally, we are using a host of location based coordination councils to address local issues:

- Councils and executive steering committees to oversee a wide range of operational and resource dimensions across division lines
- A Tax Administration Council whose purpose is to see that essential tax administration policies and procedures affecting taxpayers in more than one business unit are appropriately consistent and in accord with the law. In addition, this Council will oversee efforts to ensure tax legislation is effectively implemented.

- Cross-divisional councils for overseeing the redesign of our core business systems and modernizing the technology to support them, according to the blueprint.
- IRS-wide councils to address selected management policy issues, such as Human Resources. Such councils recommend common management policies, facilitate the exchange of best practices, and give direction to any activities managed in common.

### **1(a)(2) What difficulties have arisen in the transition to 4 operating divisions?**

A natural learning curve occurs in a transition as sweeping as the one that the IRS is undertaking. Just a year ago, we managed IRS operations through geographically defined line units (districts and service centers), supported by a large functional structure (Examination, Collection) in national and regional offices. Today, we are organized around groups of like taxpayers, and the divisions have end-to-end accountability for all the functions and processes which affect those taxpayers, in every geographic location.

Making a change this big is no easy task. Compounding the challenge is the need for us to couple the modernization of the organization with the modernization of business practices and the technology. All three of these elements of the modernization are necessary for success and very much interdependent. We expected and planned for difficulties during the transition, and a number of difficulties have actually arisen.

One difficulty we are experiencing is getting accustomed to having program responsibility assigned to one division, but program delivery carried out by several divisions. For example, most of the collection procedures are the responsibility of Small Business/Self-Employed (SB/SE), but Wage and Investment (W&I) shares program delivery responsibilities for these activities. While the divisions are charged with addressing the unique needs of their taxpayer segments, we also need to ensure consistency of taxpayer treatment. We have also identified some conflicting assumptions about program ownership among the divisions but are sorting through those issues and expect to resolve them soon.

Another difficulty is adjusting to a total “shared services” concept for our key support functions – information systems and facilities. In the new design, our support functions are managed centrally and no longer report to the operational managers. The new service delivery processes are viewed in some areas as more cumbersome and less effective than when they were under the control of the operational managers themselves. Any new system needs time to mature and it not surprising that, in this adjustment phase, the process is not working as well as it should. But we are confident that over time we will reach the level of effectiveness our design envisioned. Moreover, shared services offers a

powerful mechanism for standardizing key support operations and provides a more effective mechanism for controlling costs.

The difficulties described above are mostly internal growing pains. Externally, the reorganization has for the most part been transparent to the great majority of taxpayers. Taxpayers will begin to see more significant improvements in our delivery of services as we move to the critical next phases of the modernization -- reengineering business practices and modernizing the technology. When we have experienced difficulties with an external impact, we have managed to identify and promptly deal with the problems. For example, when we moved to the new organization we did not clearly define the responsibility for maintaining existing practitioner hotlines in each state. Once the issue was raised, the new divisions worked cooperatively to ensure that these hotlines were staffed and ready to service practitioners.

We are also moving swiftly to staff up the new pre-filing components of our Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) divisions. To date, staffing has lagged behind where it needs to be to achieve the intended level of pre-filing services. We are currently engaged in a substantial recruitment effort in both the Stakeholder, Partnership, Education and Communications (SPEC) organization in W&I, and the Taxpayer Education and Communication (TEC) organization in SB/SE.

In summary, the changes we are making will take many years to fully implement, and we will inevitably encounter risks and temporary setbacks along the way. We are managing these risks by openly confronting them, and honestly communicating what we are doing and why.

**1(a)(3) How are workarounds (temporary solutions put in place to keep the division operating until a final solution is developed) monitored such that the problem will be addressed as part of the overall plan?**

Modernization workarounds generally arose in two different situations:

- 1) Business rules had not yet been finalized in specific functions or
- 2) Required systems changes could/would not be made when initially needed

The handling of these workarounds was very different.

In the first situation, various design teams and/or the Centralized Transition Office (CTO) identified these procedural gaps, and then monitored through the Issues Tracking System. The design team discussed the most significant items during the periodic Status Meetings. When the new organization stood up in October 2000, we turned these issues over to the new divisions and their Business Systems Planning (BSP) staffs. To resolve issues that cross two or more divisions, we often commissioned special teams to study the problems and

recommend solutions. For example, we formed a team to develop a Service-wide internal mail delivery system.

We captured requirements for changes to various computer systems as they were identified, and documented them in various deliverables. We then incorporated them into formal change request documents [Requests for Information Services (RIS)]. We submitted these RIS's to Information Systems (I/S), first as "placeholders" and later as "final" requirement packages. Both I/S and Modernization then track these RIS's, until the changes are integrated into our various systems

**1(a)(4) For each of the following divisions, please summarize the significant initiatives and how these initiatives relate to the IRS's strategic goals; Wage and Investment (W&I); Large and Mid-Size Business (LMSB); Tax-Exempt and Government Entities (TEGE); Small business; Appeals; and Criminal Tax.**

The Internal Revenue Service (IRS) has three strategic goals: top-quality service to each taxpayer in every interaction; top-quality service to all taxpayers through fair and uniform application of the law; and productivity through a quality work environment.

In order to reach these goals and improve service and compliance, the IRS has incorporated ten major strategies into its strategic plan:

- Meet the needs of taxpayers
- Reduce taxpayer burden
- Broaden the use of electronic interactions
- Address key areas of noncompliance
- Stabilize traditional compliance activities
- Deal effectively with the global economy
- Meet the special needs of the tax exempt community recruit, develop and retain a quality workforce
- Provide high-quality, efficient, responsive information and shared support services
- Promote effective asset and information stewardship

### **Wage and Investment Division**

The Wage and Investment Operating Division has developed initiatives for seven of the ten strategies, as they relate to the three IRS strategic goals.

**Strategic Goal #1) Service to each taxpayer in every interaction.** Three of the ten IRS strategies relate to this goal. The first IRS strategy to "meet the needs of the taxpayers" involves offering higher quality, more readily available assistance

to taxpayers who ask for help in filing their returns and paying the taxes they owe. To support this strategy, Wage and Investment (W&I) will:

- Offer products and services tailored to specific taxpayer needs
- Provide more education and assistance through convenient, easy-to-use distribution channels
- Leverage partnerships
- Allow taxpayers to designate a Third Party Authorization on all Form 1040 series
- Expand and improve assistance to Spanish speaking customers

The second IRS strategy is “reduce taxpayer burden” by clarifying tax law responsibilities, resolving issues early in the process, providing more effective pre-filing guidance, and offering effective communication and education. To support this strategy, W&I will:

- Improve notices
- Deploy mobile units and information kiosks

The third IRS strategy, “broaden the use of electronic interactions,” is aimed to convert most interactions with taxpayers and practitioners to electronic means as rapidly as possible, including electronic payments and electronic communications with taxpayers. The W&I initiatives that relate to this strategy are to:

- Conduct marketing research to ensure that products and services meet customer needs
- Develop an e-file strategy
- Improve electronic filing and communication services
- Expand the use of self-selected personal identification numbers (PIN)

**Strategic Goal #2) Service to all taxpayers through fair and uniform application of the law.** IRS strategies four through seven relate to this goal. The fourth IRS strategy is to “address key areas of non-compliance.” IRS is promoting fairness by combating important areas of non-compliance, such as underreporting, abuse of trusts, corporate tax shelters, nonpayment of withholding and EITC overclaims. The W&I initiatives relating to this strategy are to:

- Develop risk based compliance programs
- Develop collection and exam workplans tailored to specific issues affecting those taxpayers
- Focus effort on systems changes for EITC

The fifth IRS strategy is to “stabilize traditional compliance activities” through promoting fairness in examination, collection and criminal investigation, while observing taxpayer rights. W&I’s initiative that addresses this strategy is

implementation of risk-based compliance systems that are more effective and less burdensome to taxpayers who want to voluntarily comply.

W&I does not currently have any initiatives to address strategic goals six and seven.

**Strategic Goal #3) Productivity through a quality work environment.** The last three of the ten IRS strategies relate to this goal. The eighth IRS strategy is “recruit, develop and retain a quality workforce.” IRS plans to use tools such as job specialization, research, training, technology, education and strategic hiring to build the skilled workforce needed to support the IRS goals and strategies. To support this strategy, W&I will:

- Equip employees with knowledge of unique needs and characteristic of the specific taxpayer they serve
- Deliver employees the ability to access and update taxpayer account data through a single terminal and access path
- Improve manager and leadership training
- Deliver training to equip Customer Service Representative (CSRs) with specialized areas of expertise
- Acquire and install approved workstations
- Engage frontline employees and managers in key task such as writing the manual and training materials and determining business requirements for systems
- Expand the Servicewide Electronic Research Program (SERP) and other research tools, providing training for front-line employees Redesign the content and delivery of the IRM for a web-based environment

The ninth IRS strategy is to “provide high-quality, efficient, responsive information and shared support services” by effectively managing business systems and telecommunications services to meet customers and employees needs. To support this strategy, W&I will:

- Improve the IRS web site continuously
- Facilitate communication with stakeholders via the web site
- Establish linkages to the IRS Intranet in order to improve internal communications

W&I does not have any initiatives to address strategic goal ten.

### **Large and Mid-Size Business Operating Division**

The following are the significant initiatives for LMSB and their relation to the IRS Strategic Goals:

### **1. Global Trading – A strategic initiative to build a tax administration to effectively deal with the global economy.**

Rapidly changing technology is driving the global economy and impacting business practices in every sector. The corporate organization of the immediate future is free of geographical anchors; it is transnational in operation and attitude. To support IRS goals, we will continue efforts to:

- Address specific areas of non-compliance
- Effectively use the tax treaty network (countries with which the U.S. currently has income or estate tax treaties)
- Effectively use resources
- Promote customer satisfaction by understanding issues from the taxpayer viewpoint
- Promote employee satisfaction by providing critical and timely training
- Enable development of appropriate new tax legislation

### **2. Issue Management - A strategy to resolve disputes earlier with taxpayer(s) or eliminate controversy earlier in the process.**

During the past several years, large corporate taxpayers have been dissatisfied with out examination of their returns. Factors such as increasing cycle time (the date the taxpayer filed the return to the date the case is closed out of the examination stream), inability to consistently audit the most current filed tax year return, and lack of a comprehensive, consistent issue management strategy have contributed to increased burden on taxpayers, as well as, employee dissatisfaction and significant resource and budget commitments. To support agency goals, we will continue efforts to:

- Address revamped business practices
- Enhance IRS responsiveness to customers and reduce taxpayer burden
- Assist taxpayers to be compliant and improve customer satisfaction
- Improve employee satisfaction
- Improve examination processes and resolve high-risk issues earlier in the process

### **3. Highly Skilled & Satisfied Workforce – A strategy to recruit and retain a highly qualified, skilled and satisfied workforce.**

Continued attrition of LMSB experienced employees erodes our ability to provide customer service and take necessary, effective compliance actions. We need to continue to:

- Improve our ability to attract and retain skilled employees
- Update our employees' business knowledge, accounting, and tax law skills to meet the challenges of e-commerce and the global economy

- Improve our employees' morale and trust in the IRS

Tools and training cannot address future trends. We must change the attitude and mindset of the workforce at all levels to reflect our Mission.

#### **4. Abusive Corporate Tax Shelters – A strategic and balanced approach to strengthen our ability to deal with corporate tax shelters.**

The proliferation of corporate tax shelters presents an unacceptable and growing level of tax avoidance behavior. Over the past several years, Congress and the Administration repeatedly have provided targeted responses to specific shelters as they have come to light. We need to curb the growth of corporate tax shelters as a current response, as opposed to an after-the-fact, ad-hoc approach. To meet agency goals, we will continue efforts to:

- Provide service to all taxpayers
- Promote fairness and integrity
- Address specific areas of non-compliance
- Provide a driver to future legislation
- Protect corporate tax revenue.

#### **Tax Exempt and Government Entities Operating Division**

For FY2001, the Tax Exempt and Government Entities (TE/GE) Division of the IRS is pursuing three significant initiatives. These three initiatives are part of the IRS and TE/GE Strategic Plans and directly impact the Division's ability to serve its customers, ensure compliance, and protect the public interest.

##### **(1) Address Employee Plan (EP) Determination Workload Variations.**

TE/GE's Employee Plans organization is currently in an open period for amendments to employee benefits plans to address a series of recent legislative changes. TE/GE anticipates receiving over 200,000 determination letter requests to address plan changes in FY2002, in contrast to a normal annual volume of 40,000 requests. To address this projected workload increase, we are encouraging employees to adopt standardized employee plans through marketing and outreach, improving the determination application and review process, and adding employees and other resources to help process the additional determination receipts. TE/GE is also redesigning its Determination System, which should improve processing time, efficiency and quality.

##### **(2) Ensure the Accuracy of the Exempt Organizations (EO) Master File.**

Past analysis indicates that a significant amount of information in the EO Master File may be inaccurate or out-of-date. The lack of reliable information about exempt organizations inhibits our ability to serve our customers at the level they expect. We plan to redesign the EO Master File maintenance process, expand

our current return imaging process, and work to introduce electronic filing for Form 990 filers.

### **(3) Establish the Government Entities (GE) Organization and Programs.**

Historically, the IRS has under-served government entities. To increase service to these customers, TE/GE is establishing the new Government Entities organization. We are hiring and training additional employees, strengthening the tax-exempt bond program, and establishing partnerships with customer and stakeholder groups to provide better service with limited resources. During fiscal years 2000 and 2001, our Federal, State and Local Governments (FSLG), Indian Tribal Governments (ITG), and Tax Exempt Bonds (TEB) functions will be building and refining their programs and collecting information about their customer populations.

#### **Small Business/Self-Employed Operating Division**

Small Business/Self-Employed Operating Division's Strategy and Program Plan for FY 2000-2002 contains the following strategies that support the IRS strategic goals:

#### **Strategic Goal #1) Top Quality Service to Each Taxpayer in Every Interaction**

##### ***Strategy: Increase ability to meet customer account service expectations.***

Our goal is to improve taxpayer ability to comply with the tax laws by making filing easier and providing individual service and prompt, professional treatment when tax is due. The following priority programs will assist in accomplishing this goal:

- Organize Customer Service Representatives (CSRs) by areas of expertise division-wide, using call routing effectively to provide specialized customer service via intelligent electronic call routing. At the same time, instead of being a "phone" assistor, or a "correspondence" assistor, these specialists will assist based on their expertise, regardless of the channel through which the taxpayer contacted the agency. SB/SE, as well as Wage and Investment Division (W&I), are adopting a more knowledge-specific approach to customer service, designed to increase both the quality of assistance taxpayers receive and the speed with which we assist them.
- Designate additional trained phone assistors to provide adequate staff for both technical and account calls. W&I has taken similar steps.
- Support W&I operated field assistance sites with technical backup.

- Establish a methodology to develop e-government prototypes for SB/SE, and test the prototypes. The Internet is changing the way businesses operate and, by extension, the tax issues that confront businesses and the IRS.

Additionally, SB/SE is pursuing several improvement projects to further increase its ability to meet customer account service expectations. We will:

- Centralize 941/943 Federal Tax Deposit penalties and the related analysis and abatement processes into two or fewer centers.
- Review the Business Master File Submission Processing process and develop a process that will identify best practices in the service centers and help ensure consistency of approach.
- Centralize 1120-S (Subchapter S Corporation Return) and 2553 (Election by a Small Business Corporation) processing. The planned centralization from 10 centers to the Ogden and Cincinnati Submission Processing Service Centers should reduce mishandling of the elections and erroneous conversions of the corporate returns.
- Create a centralized toll free number for practitioners.
- Store all Centralized Authorization File (CAF) input, power of attorney information, authorizing the IRS to have contact with the taxpayer's representative in one place.
- Improve the Employee Identification Number (EIN) process through better taxpayer communications, support to customer service representatives, and business processes.

***Strategy: Prevent compliance issues among start-up business through education and assistance.*** SB/SE will expand our business partnerships, specialize education programs for market segments, and assess current successful business programs. To assist in accomplishing this goal, we will:

- Expand partnerships with established institutions, such as the National Association of Enrolled Agents and Association of Small Business Development Centers to provide joint products and services.
- Establish a measurement program to determine the effectiveness of efforts to address noncompliance issues among start-up businesses.
- Develop specialized education programs for market segments to support the overall IRS goal to develop market segment strategies to improve industry compliance.

- Assess and expand successful programs, such as the IRS Digital Daily web site. This site features a special section for small business taxpayers, which offers an array of information. We will add additional tax information, simplify access, and ease navigation throughout the site.

**Strategic Goal #2) Service to All Taxpayers through Fair and Uniform Application of the Law**

**Strategy: *Stabilize and improve business results in Examination and Collection.*** SB/SE will accomplish this strategy by maximizing other resources to minimize the impact on Examination and Collection casework during the filing season. To assist in this effort, we will establish priority programs to:

- Maximize filing season use of resources from Taxpayer Education and Communication, Stakeholder Partnerships Education and Communication, and field assistance to minimize impact on Examination and Collection casework
- Centralize processing of offers in compromise to improve quality, timeliness, and efficiency
- Standardize criteria to reassign certain compliance cases, including Innocent Spouse, to Wage and Investment personnel
- Use data from the Examination and Collection Quality Measurement Systems, and audit recommendations from the Treasury Inspector General for Tax Administration to target training and quality improvements
- Implement an integrated SB/SE and Criminal Investigation trust fund compliance strategy to reduce pyramiding of trust fund taxes by in-business taxpayers
- Centralize Examination selection to keep the case selection process separate from those who actually conduct the examination and to redefine the classification criteria for returns over \$100,000
- Focus Examination resources in known areas of noncompliance using available databases to stratify portions of the taxpayer population and determine where areas of noncompliance exist
- Redesign core processes to reflect the new organization's goals and objectives to improve customer service

**Strategy: *Expand successful voluntary compliance agreement program.***

To further address service to all taxpayers, SB/SE expanded voluntary compliance agreements to include all agreements, policies or programs designed

to improve compliance without the use of enforcement tools. These are alternative treatments. To accomplish this goal, we will:

- Inventory all voluntary compliance agreement and similar programs. Voluntary compliance agreement programs have shown that partnering with associations and similar taxpayer groups produces agreements that reduce identified types of noncompliance.
- Design a process for creating new alternative treatments. The expanded use of alternative treatments will enable SB/SE to reach additional customers and customer segments.

**Strategy: Address underreporting, nonfiling, abusive trusts and pass throughs.** To accomplish this strategy, we will:

- Initiate Schedule K-1 matching and use to target compliance resources
- Increase Examination focus on partnerships, trusts, and offshore compliance and provide training to our employees on the related law
- Expand efforts with Criminal Investigation to expose flagrant promotions, identify criminal violations, and develop joint projects in specific sub-markets
- Consider using targeted notices and guidance
- Develop a Communications Outreach Strategy to educate, inform and assist the trust community on trust filing requirements and abuses observed

### **Strategic Goal #3) Productivity Through a Quality Work Environment**

**Strategy: Increase employee skills and confidence in management.** To achieve productivity through a quality work environment, we will emphasize this strategy. Increasing employee skills and confidence will increase employee satisfaction and hold the agency's employment stable while the economy grows and service improves. To accomplish this goal, we will:

- Develop specific career paths for Compliance and Taxpayer Education and Communication personnel
- Plan and deliver targeted learning programs for employees in key occupations
- Engage front-line employees and managers in key substantial tasks, such as rewriting the individual master file

- Partner with private industry on the redesign and delivery of recruitment training

## **Appeals**

Appeals provides taxpayers with an independent impartial review of their cases after an audit is completed or collection action is proposed. It is the last opportunity for the IRS and the taxpayer to agree before a case goes to court. Appeals plays a critical role in ensuring that taxpayers have an opportunity to resolve their dispute.

Keys to the success of the Appeals function include three factors: its independence, impartiality and fairness. Taxpayers will continue to receive high-quality service from the offices that serve them now. To ensure the IRS strategic goal of improved customer service and satisfaction, Appeals will focus on streamlining its processes and offer new services like Fast Track Mediation. A snapshot of the new Appeals reveals:

- An organization with three operating units: Wage & Investment (W&I), Small Business/Self-Employed - Tax Exempt/Government Entities (SB/SE-TE/GE) and Large & Mid-Size Business (LMSB). W&I's stand-up will occur approximately 18-24 months after the other Appeals units become operational.
  - SB/SE-TE/GE activities involve cases covering corporations with less than \$5 million in assets, collection issues, estate and gift tax cases, self-employed cases, tax exempt entities, and government entities. This unit will also have responsibility for the current Records and Processing sections. Other program responsibilities include innocent spouse, Freedom of Information Act appeals, excise and employment tax, Alternative Dispute Resolution (ADR) of bankruptcy, dyed diesel fuel and tax exempt bond cases. Initially, all W&I appeal cases will be processed by the SB/SE-TE/GE Appeals organization until the W&I Operating Division is operational.
  - LMSB activities cover corporate and partnership cases with assets greater than \$5 million with the most complex issues, particularly international issues. It will include such activities as the Industry Specialization Program, Large Case ADR, Joint Committee, international issues and competent authority.
- An empowered workforce of appeals officers who have delegated settlement authority on a limited basis.
- A team-based environment for Appeals staff to increase quality and responsiveness.

- New processes to resolve taxpayer disputes faster, such as Fast Track Mediation and the Mutually Accelerated Appeals Process. The Fast Track Mediation program allows examiners and SB/SE taxpayers an opportunity for mediation, with an appeals officer acting as a mediator, to assist the parties in resolving their disputes. Under the Mutually Accelerated Appeals Process, Appeals and the taxpayer set accelerated timelines and apply additional resources to more quickly resolve large, complex corporate cases.
- Improved feedback processes with compliance areas to ensure high-quality case development

### **Appeals Mission:**

To resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

### **Strategic Priorities:**

- Ensure that each taxpayer has the right to resolve a dispute in an independent and timely administrative process, without going to court
- Reduce the length of the Appeals process
- Improve taxpayer awareness of Appeal rights and processes
- Increase confidence in the overall fairness of the tax system by providing an efficient, independent administrative appeal process for all taxpayers.

### **Appeals Initiatives**

The Appeals Division has developed initiatives to meet the IRS's strategic goals:

**Strategic Goal #1) Service to each taxpayer.** Appeals is taking steps to reduce the length of the Appeals process. To meet this goal, Appeals is working to:

- Reduce backlogs for Coordinated Examination Program (CEP) and Collection cases
- Improve case development/expedite case movement
- Project character of potential Appeals cases
- Implement staffing model to meet changing customer requirements

To accomplish this strategy we plan to implement several new programs and enhance already-existing programs:

- Integrated Collection System: Make available on workstations

- Appeals Centralized Database System (ACDS): Enhance ACDS and enable it to receive case and issue information electronically from supplier and customer organizations; complete software fixes. - Mutually Accelerated Appeals Process (MAAP): The MAAP initiative is designed to reduce the time it takes to resolve Coordinated Examination Program (CEP) cases in Appeals
- Appeals Quality Measurement System (AQMS): AQMS will measure the overall product quality of the Appeals organization
- Test New Business Processes: Team Concept/Settlement Authority will create cultural changes that will expedite case closure by eliminating post-settlement approval for a majority of cases. Fast-Track Mediation, which utilizes Appeals mediators at the Compliance level to resolve cases at the lowest level, began its pilot on July 1, 2000 in four locations—Denver, Hartford, Jacksonville, and Houston—and has been extended through June 2001.

**Strategic Goals #2) Service to all taxpayers through fair and uniform application of the law.** Appeals is improving taxpayer awareness of Appeal rights and processes by:

- Addressing appeal rights in notices, publications, and procedures
- Simplifying and personalizing communications for individual taxpayers
- Tailoring communications and processes for pro se taxpayers

### **Criminal Investigation**

Criminal Investigation investigates potential criminal violations of the Internal Revenue Code and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.

This mission statement captures our role in tax administration, as well as the public's expectations as to how we should perform that role.

Criminal Investigation has invested considerable energy and time into supporting the overall mission of the Service and its strategic goals. While a new mission statement and clarification of the public's expectations are fundamentally important, CI must also set specific goals and objectives to achieve the mission of enforcement when compliance is not met.

#### **1. Top-quality service to each taxpayer in every interaction**

Criminal Investigation has devised strategic initiatives to provide service to each taxpayer.

In the area of pre-filing education to the taxpayer, we created the Office of Communications and Education (C&E). The office is charged with developing and managing a market driven educational program to foster voluntary

compliance. We have selected, trained and assigned public information officers to the 35 field offices. They gather, create and disseminate deterrent publicity and educational media to taxpayers and other external stakeholders. A key marketing tool has been the use of "bundling". This mechanism allows for legal actions to be categorized and rolled into a larger media piece that can then be directly channeled into a market segment, occupation or other identifying groups (such as abusive trusts, return preparers). We have and will continue to aggressively provide taxpayer education by publishing information on abusive trusts, employment taxes and other organized tax evasion schemes as they emerge and threaten the public support of our tax system. We will continue to add information and other news articles to the CI Web site for media use and public access. The expansion of the CI Web site means increased media access, media coverage, and public awareness of our efforts to educate the taxpayer. In addition, the CI Web site has been a reference link in various other web sites seeking to educate and alert the public.

We coordinate our pre-filing education and continuous education initiative throughout the year with internal and external stakeholders to ensure the messages generated, developed, and disseminated accomplish our goal of speaking with "one voice"

In addition to the creation of a communication and education office serving both internal and external customers, CI created the Criminal Investigation Research section in the Office of Strategy. We believe that only through data research and evaluation can we truly provide service to each taxpayer. The analysis of the research will yield identification of trends, emerging fraud schemes and issues, and support development of strategic priorities to improve operational effectiveness and service.

We believe the concerted efforts of the Operating Divisions and the functions will rate well with the taxpayers as we work to provide quality service and professional treatment in the administration of the tax laws.

## **2. Top-quality service to all taxpayers through fair and uniform application of the law**

One result of our modernization and re-engineering is our creation of CI's Office of Strategy. We needed data to help us address all aspects of noncompliance. To provide service to all taxpayers and address the issues resulting from the non-compliant portion of the public, CI retooled its workforce, revised its strategy to emphasize criminal tax investigation, and created mechanisms to monitor and direct its workload.

CI devised an interim compliance strategy that emphasized channeling IRS resources to criminal tax investigations and high level financial crime

investigations. This initiative helped assure the American public that tax crimes and organized evasion schemes were serious crimes.

CI became a member of high level councils to ensure the IRS designed a cross-functional approach to address taxpayer issues and combat noncompliance. CI's participation with the Operating Divisions, combined with its own research efforts, resulted in the development and implementation of several operational initiatives to attempt to secure compliance across the board.

The following initiatives highlight our current thinking and efforts:

### OPERATIONAL INITIATIVES

- **Operational Initiative 1: Target legal income cases important to compliance.** Criminal Investigation will issue Annual Compliance Guidance (ACG) to all field offices once the CI Strategic Program Plan (SPP) is updated for the coming fiscal year. The ACG will provide detailed guidance to field offices on the steps required by the SPP. Through this process, we will tie the SPP to field operational goals and update field office guidance on an annual basis.
- **Operational Initiative 2: Invigorate the Fraud Referral Program.** CI established a partnership with the Small Business/Self Employed Operating Division (SBSE) to improve the referral process. Criminal Investigation will actively participate in the selection and training of the SBSE fraud specialists.
- **Operational Initiative 3: Establish Lead Development Centers.** We will establish Lead Development Centers (LDC) within each CI Area during FY 2001. The Lead Development Centers will develop investigative leads from information provided by special agents, Operating Divisions (ODs), Fraud Detection Centers and other sources. We will evaluate the information for potential criminal violation through database research and analysis. We will forward the resulting "leads," which indicate criminal violations within IRS jurisdiction, to the appropriate CI field office for investigation. The LDC will ensure that "leads" referred for investigation meet the criteria and goals established in the CI Compliance Strategy. We will refer "leads" that indicate possible civil rather than criminal violations will be referred to the OD's for appropriate action. Additional LDC's will become operational in FY 2002.
- **Operational Initiative 4: Increase Communication and Cooperation with ODs at all levels.** We have established the Financial Crimes and Planning & Strategy Sections and are partnering with the other Operating Divisions. WE are developing procedures to share information during the "strategic assessment" segment of the Strategic Planning Process.

- **Operational Initiative 5: Apply sufficient resources to maintain an effective Refund Fraud Program.** Implementation of the Fraud Detection Center (FDC) blueprints is underway and on schedule. The management staff is fully in place and the first wave of investigative analysts and aides are onboard. CI's training program is also on target with the Investigative Analyst, updated fraud detection, and computer skills and BMF training completed.

In addition to the above initiatives, Criminal Investigations anticipates increases in the E-Commerce fraud. CI, as well as the other Operating Divisions, faces major challenges as commerce moves into the global, electronic method of operation and taxpayers file more returns electronically. Criminal Investigation must effectively educate, monitor, and enforce the income tax laws and related statutes in this environment. CI's response to the IRS' efforts to ease filing and the impending threat caused by E-Commerce fraud and identity fraud is the creation of an Electronic Crimes Section.

The aforementioned objectives and creation of the Electronic Crimes Section will further the enforcement efforts of CI in seeking uniformity in the identification, investigative evaluation and potential prosecution of taxpayers that do not voluntarily meet their tax obligation or seek to erode the public's confidence in the tax system.

### **3. Productivity through a quality work environment**

CI recognizes its employees must accept ownership of the strategic goals, receive necessary support crucial to providing good service to its customers, and be able to communicate upward and across the organization effectively about problems and obstacles to quality and professional service. In order to function, CI must be able to stabilize the level of enforcement activity, so employees can take the proper action in each case.

CI has put in place several operational initiatives to increase productivity by stepping up its hiring initiative and strengthening its existing workforce. The following operational initiatives are underway:

#### OPERATIONAL INITIATIVE

- **Operational Initiative 1: National recruitment program.** CI initiated a national advertising campaign. In addition, we are developing an automated application system to increase the potential applicant pool.
- **Operational Initiative 2: Strengthen Special Agent (SA) training.** CI will continue its efforts in retooling its workforce. Efforts at all levels of the organization will focus on providing criminal tax investigation training to meet the challenges of a global and Internet driven economy. The National Criminal Investigation Training Academy (NCITA) will ensure special agents receive the necessary criminal tax training. IRS recently received permission

to contract with instructors. Additionally, CI plans to hire re-employed annuitants as instructors, utilizing the waiver of pension offset where appropriate. The ability to contract directly with instructors as well as the re-employed annuitants, will allow CI the capability of transitioning skills to new agents by recruiting for hire many of its highly skilled former special agents as NCITA instructors.

- **Operational Initiative 3: Explicitly targets new SA hiring to highest priority geographic areas.** Criminal Investigation has gained the support of the Office of Program Evaluation and Risk Analysis (OPERA) to identify the statistical drivers of legal income investigations to determine where special agents should be stationed.

**1(a)(5) LMSB has developed several initiatives that appear aimed at the needs of the largest companies under its jurisdiction. What initiatives will assist the smaller companies under LMSB jurisdiction?**

We developed issue resolution initiatives to address the needs of all LMSB taxpayers. During our modernization design and implementation phases, we placed emphasis on developing processes and products that would benefit all LMSB taxpayers. We used pilot programs to test these new design processes and products. When we complete the pilot and implement a permanent program, the new products and issue resolution processes will be available to all LMSB taxpayers that meet the program requirements (e.g., Pre-filing Agreement Program).

LMSB recognizes there are specific customer needs for the LMSB mid-market taxpayer and believes that the new initiatives will benefit the mid-size and smaller LMSB taxpayer. In addition, we have taken actions to coordinate issue management initiatives with the Small Business/Self-Employed Operating Division and will continue to coordinate efforts to provide enhanced published guidance to both of our taxpayer segments.

The **Pre-Filing Agreement (PFA) Program** is now a permanent LMSB program open to all LMSB taxpayers meeting established criteria (see Rev. Proc. 2001-22 for the PFA procedures). Under the PFA program, a LMSB taxpayer may request examination and resolution of a factual issue involving well established legal principles likely to be disputed in post-filing audits before the income tax return reporting the transaction is filed. We charge a user fee ranging from \$1,000 to \$10,000, based on the taxpayer's asset size. A closing agreement completes the process, binding both the taxpayer and the Service as to the tax treatment of the transaction in question.

The **Industry Issue Resolution (IIR) Program** is still in the pilot stage with completion planned for November 2001. Our goal is to provide guidance on frequently disputed industry issues to a number of affected LMSB taxpayers,

rather than on case-by-case rulings or post-filing audit determinations or rulings. The current dispute resolution vehicles are taxpayer specific and thus are resource intensive and may result in conflicting decisions from lower courts and appellate court circuits. Although the emphasis is on prospective guidance in the form of Revenue Procedures providing safe harbor rules, such guidance may also be applicable at the post-filing stage depending on the nature of issues. The guidance resulting from the IIR process will apply to all taxpayers within an industry.

Characteristics of potential IIR issues are:

- Bona fide, fact specific transactions where the appropriate tax treatment is uncertain
- Frequent and repetitive examination of the same issue because of the uncertainty of the tax treatment
- Significant number of taxpayers in a given industry are affected by the issue
- Factual issues, rather than legal interpretation, are in dispute.

We announced the **Comprehensive Case Resolution (CCR)** as a pilot program in August 2000. Under this pilot LMSB taxpayers could request resolution of all open issues for all open tax years under examination in LMSB, in Appeals, or before the U.S. Tax Court. We announced a second pilot to extend the application period to April 30, 2001.

The goal of the CCR program is to expedite resolution of all disputed issues by bringing all functions of the IRS making tax treatment determinations to work together. Taxpayers would waive their Appeals *ex parte* communication rights and agree to meet the pilot CCR processing timelines, including a requirement to complete the process in 12 months. A taxpayer may withdraw from the program within a set timeline.

For selection to the CCR Pilot Program, a case must meet the following criteria:

- The case has spent at least one open year in a Coordinated Examination (LMSB) and one year in Appeals or docketed in Counsel
- The audit of the LMSB years is substantially complete
- The case is likely to be closed in the CCR Pilot Program within 6 to 12 months, and
- The Appeals case is not likely to be settled before the CCR first conference.

**1(b) During Problem Solving Days, representatives from the various functions (e.g. examination and collection) are available to assist the taxpayer in resolving his or her tax issues. The IRS recently created “tax resolution representative” positions, which combine both collection and examination duties.**

**1(b)(1) Aside from Problem Solving Days, what efforts have been made to provide one-stop service for taxpayers?**

Beginning this year, any day can be Problem-Solving Day. Taxpayers will be able to call toll-free to schedule a telephone or in-person conference at their convenience to resolve matters too complex for the usual IRS service channels. In addition, two national Problem-Solving Days will be held on Saturdays in June and November.

Two additional efforts to provide one-stop service to taxpayers are:

- The Tax Resolution Representative (TRR) position, created to resolve a wide range of taxpayer problems. TRRs are generalists with strong cross-functional skills. The TRR will be able to resolve most walk-in issues that arise at the Taxpayer Assistance Centers with a single interaction and offer a face-to-face channel for taxpayers on Compliance issues, especially during non-peak filing season. In addition to providing technical training, the Taxpayer Assistance Centers will have mechanisms set up to help the TRR resolve issues beyond their scope of training (e.g. a hotline to SB/SE).
- The Accounts Resolution Guide currently used by Customer Service Representatives. It provides step-by-step procedures to answer account inquiries from beginning to end. Our Information Systems staff will provide the ability to link the guide with our Case Processing System, giving us instant interface with Internal Revenue Manuals and other research information. The improved version streamlines the research and resolution process by being more customer-focused. Employees will link to “pop-up and drop-down” menu information based on responses provided by taxpayers.

**1(b)(2) How many “tax resolution representatives” are currently available to work on cases? How are they dispersed throughout the IRS, i.e., are they dispersed both geographically and functionally?**

We have 1,072 TRRs, with another 550 to be hired by the end of September 2001. These TRRs are employed in 410 Tax Assistance Centers, located throughout the country. They are not functionally dispersed but all lines report through the CARE Field Assistance operations to the Commissioner, Wage and Investment.

**1(c) It is our understanding that the Field Service function of the Office of Chief Counsel has been eliminated. How are requests from the field covering several subject areas coordinated to ensure that uniform advice is given to the field?**

While we eliminated the Field Service Division of the former Office of the Associate Chief Counsel (Domestic) in the recent reorganization, the reorganization did not eliminate the performance of the functions previously carried out by the Field Service Division. The reorganized offices that emerged from the reorganization now perform both “field service” and “technical” functions. We coordinate cases involving matters within the jurisdiction of more than one Associate office in the same manner as prior to the reorganization.

To better understand how the newly reorganized Associate Chief Counsel Offices combine field service and technical functions, it is helpful to understand what those functions are. We have no formal definition of “field service” or “technical” functions, and the lines between those functions are not always clear. Broadly speaking, field service functions include case specific assistance to the Field on matters such as case development during the audit stage or during consideration in the Office of Appeals, other than through the formal Technical Advice process. It also includes assistance to the Field on matters in litigation at the trial level as well as on appeal and on certiorari to the Supreme Court. Technical functions include broad, published guidance in the form of regulations, revenue rulings, notices, etc., as well as private letter rulings and formal technical advice on case specific legal issues outside of the litigation process. There are many other responsibilities of the Associate Chief Counsel offices that do not fall squarely within one function or the other.

Prior to the reorganization, the Offices of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) and the Associate Chief Counsel (International) fully or partially integrated their technical and field service functions. In other words, branches (the lowest organizational level) would perform both field service and technical functions. For example, the same branch that drafted a regulation might also review a trial brief and later an appeal recommendation concerning the interpretation of that regulation. If a case involved issues that covered subject matters outside the branch’s area of responsibility, the branch would request assistance from the office or offices that had responsibility for that subject matter. The respective offices then coordinated their efforts to provide a single response to the Field office that requested the assistance.

The former Office of the Associate Chief Counsel (Domestic) did not integrate its field service and technical functions. It had a separate Field Service Division with branches whose subject matter jurisdiction generally mirrored the subject matter jurisdiction of one of the four technical divisions within Domestic. Procedures within Domestic required coordination of most issues between the Field Service branch and its technical counterpart division and vice versa. When the Field Service received a request that involved subject matters outside the jurisdiction of the assigned Field Service branch, the branch would request assistance from the office having jurisdiction over that subject matter. If that subject matter was within Domestic, the Field Service branch would request assistance from another

Field Service branch. That branch, in turn, would coordinate with its technical counterpart. If the subject matter was not a Domestic issue, the branch would coordinate with the responsible Associate Chief Counsel, e.g., the Associate Chief Counsel (INTL). The Field Service branch would then consolidate all the responses to the requests for assistance and send the consolidated response to the Field office that sought the assistance from the National Office.

In summary, although under the reorganization, the Office of Chief Counsel eliminated the Office of Associate Chief Counsel (Domestic) and the Field Service Division, the field service functions of the former Field Service Division and the technical functions of the former Domestic technical divisions are now integrated in a manner similar to those of the Associate Chief Counsel (International) and the former Associate Chief Counsel (Employee Benefits and Exempt Organizations). Branches in these newly reorganized offices now perform both technical and field service functions. When cases raise issues concerning subject matters outside the jurisdiction of the branch, the branch requests assistance from the office having jurisdiction over those issues and coordinates the response in the same manner as before the reorganization.

**1(d) What is the function of operating division counsel? How does the operating division counsel interact with the Chief Counsel's office?**

The Division Counsel for Wage and Investments, Small Business/Self Employed, Large and Mid-Size Business, Tax Exempt and Government Entities, and Criminal Tax are part of the Office of Chief Counsel. The Division Counsel serve as the senior legal advisor and expert consultant to Treasury, Service and Counsel executives and officials on the legal issues, regulations, and needs relevant to serving the taxpayers within their respective divisions, or, in the case of Criminal Tax, the client. In addition, the Division Counsel provide legal services that range from program design and strategy, to legal advice to litigation representation. Each Division Counsel has offices around the country. Division Counsel attorneys provide local legal services to the field offices, are responsible for representing the Commissioner in litigation in the Tax Court and coordinating litigation with the Department of Justice in the Court of Federal Claims and the district courts. The Division Counsel provide legal services to the Division Commissioner and other headquarter and field operation personnel.<sup>1</sup> They are responsible for coordinating legal issues with the technical subject matter experts in the various Associate Chief Counsel offices in the National Office.

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<sup>1</sup> Some Division Counsel, such as Tax Exempt and Government Entities (TEGE) and Criminal Tax (CT), are more fully integrated with their respective Division Commissioner than other Division Counsel. For example, CT attorneys conduct case reviews, review all search warrants, participate in operational planning, conduct taxpayer conferences, and share work space with Criminal Investigation (CI) employees.

## 2. Technology

### **2(a) What progress has been made to convert the master file into a real-time, modern database format, such that IRS employees will have access to up-to-the-minute taxpayer records and information?**

The Customer Account Data Engine (CADE) will provide a modern system for storing, managing, and accessing authoritative records of taxpayer accounts, replacing existing antiquated master files and information returns processing systems. It will develop a central database for managing taxpayer information and software systems that support different transactions using taxpayer account information.

In March 2001, CADE completed the systems requirement review. These requirements form the basis for systems design, development and deployment. In March, the PRIME Alliance initiated the Systems Design phase, which will be followed by systems development. Systems development includes the building of the business solution, integrating the system with other business systems, piloting and testing.

CADE's full deployment of the Individual Master File (IMF) is expected by 2006. The planning to incrementally stage Business Master File and Information Returns Processing functionality on the CADE IMF footprint will start October 2001.

### **2(b) The Treasury Inspector General for Tax Administration ("TIGTA") has noted that the IRS can be a major political and economic target for terrorists, computer hackers, and unscrupulous employees. What steps has the IRS taken to prevent outsiders and insiders from breaching IRS security and illegally accessing taxpayer information stored on IRS computers?**

The IRS has long understood that protecting taxpayer information is essential to the operation of our self-assessment tax system. The IRS established policies and procedures to protect the security and confidentiality of taxpayer information in accordance with applicable laws and federal guidance, including the Privacy Act of 1974, the Computer Security Act of 1987, and Section 6103 of the Internal Revenue Code. A particularly noteworthy example is the Taxpayer Browsing Protection Act, which was signed into law in August 1997. In short, this law helps to better address internal threats to taxpayer records by making all cases of willful unauthorized access and inspection of taxpayer records – electronic and paper – a crime. In addition, the Government Information Security Reform Act of 2000 requires the IRS to implement an “agency-wide risk-based security program”, to assure that security is addressed throughout the systems life cycle, by conducting continuous reviews of the security assurance level of our corporate assets.

Since 1997, the Office of Security, within the IRS, has been actively involved in identifying and correcting security weaknesses throughout the IRS. The General Accounting Office, the Treasury General for Tax Administration (TIGTA) and the Office of Security identified these weaknesses. The Office of Security conducts comprehensive security reviews of IRS facilities that identify both local and systemic weaknesses that require either local action or broader steps such as policy guidance, revised operating procedures, training or new technological approaches. During the four years since 1997, we have made major improvements in physical, data and systems security assurance, although a number of weaknesses remain. The General Accounting Office made note of IRS progress in this area in their most recent High Risk Update (January 2001), in which they state "IRS has made notable progress in improving computer security at its facilities, corrected a significant number of identified weaknesses, and established a Service-wide computer security management program that should, when fully implemented, help the agency effectively manage its security risks". Some of our significant achievements include:

***1. Improvement of the security status of existing systems.***

We have developed and implemented security standards and procedures have been developed and implemented for the installed base of systems, including standards for IBM mainframe systems, Unisys systems, UNIX, and Windows NT systems. We conduct vulnerability assessments are conducted using these standards as a baseline.

***2. Development of security architecture for the IRS modernized systems environment.***

IRS hired Computer Sciences Corporation as its PRIME contractor for BSM. IRS and CSC together with several other leading technology and management companies form the Prime Alliance. This alliance forms the main public/private partnership in BSM. Working with the PRIME Alliance, the IRS has established an Enterprise Architecture that has integrated security features throughout the architecture.

***3. Improvements to the established systems certification and accreditation process.***

The IRS has made progress in improving its paper-based systems certification and accreditation process. First, it has built it into the systems life cycle used for developing new systems. Second, it is automating the process to make use of automated tools and government best practices.

***4. Continuing emphasis on the Unauthorized Access (UNAX) program.***

In 1997, the IRS established its UNAX program to focus on manager responsibility and communication to employees, to establish and maintain a

culture of personal responsibility and accountability, and to protect the confidentiality of taxpayer records. We have taken a number of steps, including expanding the ability to detect unauthorized access through tracking tools, communicating extensively about UNAX prohibitions, issuing written guidance to managers and employees, administering stringent penalties, and tracking disciplinary outcomes to determine effectiveness.

**5. *Creation of an enterprise Computer Systems Incident Response Center (CSIRC).***

The IRS improved its incident response capability with its recent establishment of the CSIRC, which focuses on managing incident detection and response agency-wide. A cooperative effort between Information Systems Operations, TIGTA and the Office of Security, we created the CSIRC to provide real time monitoring, allow IRS to respond to security incidents quickly and precisely, and provide the documentation necessary to prosecute intruders.

**6. *Facilities upgrades to improve security***

Over the last 4 years the IRS has dramatically improved physical security at key facilities. Work continues in this area. We cannot identify locations & the nature of the upgrades in answering this question in writing, because of sensitivity issues. However, we can arrange for a specific briefing on these issues.

**7. *Development of assessment tools and techniques that allow IRS to identify and prioritize areas of vulnerability in an objective, measurable manner.***

IRS has adopted, modified and implemented the draft Information Technology Security Assessment Framework developed for the Federal Chief Information Officer Counsel by the National Institute of Standards and Technology. This Framework provides a structured tool for IRS to use in assessing the security posture of the enterprise, and ties that assessment to strategic and tactical plans that will facilitate prioritization of resources.

As with any organization, the resources available for security enhancements and upgrades are limited and must be prioritized. Many of the corrective actions we are taking are multi-year efforts. In 2001, we are further enhancing our cyber-security capabilities to better deal with increasing threats from hackers, viruses and other breaches. Because the solutions are complex and involve specialized skills, we are working with other federal agencies to identify best practices. As we are increasingly relying on centralized systems, we have also focused our security efforts on identifying the physical security and disaster recovery capabilities needed to mitigate the risks associated with terrorist threats. Although we have been able to reallocate resources to address most risks, others still exist that will require substantial longer-term investments, which are currently unfunded.

At IRS, we understand that although new technologies will help to streamline the agency's operations and improve the delivery of services to taxpayers, these same technologies must be controlled to ensure adequate security. This continues to take on greater significance as IRS' reliance on paper decreases and its dependence on new technologies increases. To support this new service delivery, IRS plans to move toward a more comprehensive Mission Assurance approach, creating a more seamless relationship between security and the business processes of the organization. To accomplish this we must involve business executives more intimately in the risk management of the assets and business processes they manage.

In summary, the IRS has taken many significant steps during the past four years toward implementation of a robust, reliable and responsive security program to protect taxpayer data from external and internal intrusion. These steps address the issue comprehensively by focusing on all aspects of security – information, personnel, physical – and incorporating both advanced preventive measures and remedial mitigating measures for weaknesses that are already documented. We believe that the IRS program will become even stronger during the next several years as we strengthen the bond between security and the business processes of the IRS and build security into the structures that are the foundation of a modernized IRS.

### 3. E-Filing

**The IRS Reform Act set a goal for the IRS to have at least 80 percent of all tax returns filed electronically by the year 2007.**

#### **3(a) What steps have been taken to meet this goal?**

During the past several years, the IRS has made significant progress toward accomplishing the goal established by the Congress. In accordance with the requirements of RRA98, we issued a strategic plan titled "A Strategy for Growth" that articulates Electronic Tax Administration's mission, goals and strategies for revolutionizing how taxpayers transact and communicate with us. We designed the strategic plan for Electronic Tax Administration to eliminate barriers, provide incentives and use competitive market forces to make progress toward the overriding goal that taxpayers will file 80 percent of all tax and information returns electronically by 2007.

As a step towards meeting this goal, IRS presented the following initiatives for 2001:

- Enabled 23 new forms that will increase participation in the e-file program;
- Authorized taxpayers to give the ERO the authority to enter their Self-Select PINs for the current year;
- Increased the number of certain schedules that can be filed electronically –
  - Schedule E – from 5 to 15 (Supplemental Income and Loss)
  - Form 4562 – from 8 to 30 (Depreciation and Amortization)
  - Form 6198 – from 5 to 10 (At-risk Limitations)
  - Form 4835 – from 2 to 4 (Farm Rental Income and Expenses)
  - Form W-2 – from 20 to 50 (Wage and Tax Statement)
  - Form 8271 – from 1 to 2 (Investor Reporting of Tax Shelter Registration Number)
- Accepted electronically filed Forms 1040, 1040A and 1040EZ from U.S. possessions.
- Offered taxpayers the option of filing their Form 4868, Telefile with Direct Debit, over the telephone.
- Authorized the acceptance of TY 2001 estimated tax payments concurrently with e-file, direct debit.
- Expanded FedState TeleFile Program to include Oklahoma and Georgia.

- Added new credit card processor – Phone Charge – that offer phone and Internet access.

Based on these changes, IRS e-file receipts have continued to increase this filing season. Through March 8, 2001, approximately 27.5 million taxpayers filed electronically, a 9.5 percent increase over the prior year. Nearly 25,000 taxpayers have authorized automatic withdrawals as of March 3, an increase of 42 percent over the same time last year.

A wide range of electronic filing and payment options is also available to businesses. During 2000, the Electronic Federal Tax Payment System (EFTPS) processed more than 63 million federal tax payments, totaling more than \$1.5 trillion. Employers can also file their quarterly employment tax returns, Form 941, electronically either through a payroll service provider, on-line from their office computer, or else small businesses can use the 941 TeleFile system to file over the telephone. For the first time this year, employers can also file their annual unemployment tax return, Form 940, electronically. Congress mandated the electronic filing of Form 1065, Partnership Returns, for Partnership with 100 partners or more in 2001.

### **3(b) When can taxpayers expect to file their tax returns over the IRS's Web site?**

The IRS will issue a report to the Congress on filing over the Internet later this spring. We are preparing the report in accordance with the FY 2001 Treasury, Postal Service and General Government Appropriations Bill, which states:

In its June 30, 2000 annual report to Congress, the private sector Electronic Tax Administration Advisory Committee (ETAAC) emphasizes its position that IRS should stress partnerships, not competition with the private sector and state and local governments in achieving its electronic tax administration objectives. In this regard, ETAAC believes it is inappropriate for the IRS to offer no-cost electronic filing over the Internet, either by developing its own software or aligning with a limited number of “authorized e-file providers.” IRS is directed to provide the House Committee on Appropriations a report commenting on this ETAAC position as well as making any recommendations to address the concerns raised by the ETAAC within 60 days of the enactment of this Act. The Committee shares some of these concerns and further recommends that IRS delay implementing no-cost Internet tax filing services until such report has been submitted to the Committee for its review.

The report to Congress will summarize the responses to a Request for Information the IRS issued last year to determine the feasibility and likelihood of the private sector offering free Internet filing to taxpayers. The report will also

reiterate prior statements that the IRS has no plans to offer Internet preparation or filing services itself in any form.

### **3(c) What security and privacy measures will be implemented to protect taxpayer privacy?**

During the past year, we completed a comprehensive set of changes and upgrades to strengthen the security for millions of taxpayers using the e-filing program. Taxpayers and tax practitioners can feel safe and secure using IRS e-file during this year's filing season. The IRS has strengthened its systems' security and remains vigilant to keeping the e-filing process the safest possible. The IRS has moved rapidly to strengthen areas identified by the General Accounting Office during last year's filing season. In all, the IRS has completed more than three dozen upgrades. The changes made by the agency include:

- Revamping the e-file system architecture
- Reconfiguring e-file operating systems
- Installing strengthened perimeter defenses
- Bolstering intrusion detection capability
- Strengthening password controls
- Improving management practices

We will continue working with our e-filing partners, practitioners, GAO and other stakeholders to guarantee that our systems remain the safest possible. During this year's filing season, we will conduct internal reviews to ensure the e-filing systems safety. However, the future of IRS security programs depends on continuing the system modernization efforts and obtaining the necessary funding to address the IRS's aging technology.

Our electronic filing systems are only open to IRS partners in the e-filing program. The general public does not have access to these modem-to-modem systems, which add an extra layer of security. We have set high standards for electronic return originators and transmitters participating in IRS e-file. We monitor and enforce stringent suitability requirements for these outside groups.

### **3(d) What is being done to develop free or low-cost filing alternatives?**

We will issue a report to Congress on filing over the Internet later this spring. The report to Congress will summarize the responses to a Request for Information that the IRS issued last year to determine the feasibility and likelihood of the private sector offering free Internet filing to taxpayers. The report will also reiterate prior statements that the IRS has no plans to offer Internet preparation or filing services itself in any form.

**3(e) What steps has the IRS taken over the past year to expand the types of returns and forms that can be filed electronically?**

We have made significant progress over the last year in increasing the number of returns that can be filed electronically. These efforts yielded the introduction of new business e-file options for Forms 940, 941 and 1065. We have expanded the number of forms and schedules available for individual filers with the addition of 22 forms/schedules for 2001 and the remaining 38 forms in 2002, providing full Form 1040 e-filing capability. We have added signature alternatives with the self-selected PIN initiative introduced during the 2001 filing season. Beginning April 2001, an on-line extension of time to file (Form 4868) will also be available through the TeleFile system. The IRS is currently piloting an on-line electronic payment system with full implementation scheduled for Fall 2001.

#### **4. Internet Refund Status Information by 2002**

**Refund inquiries significantly contribute to the demand for IRS toll-free telephone service (44 million calls in 2000). It is our understanding that the IRS plans to implement an Internet based refund status information service in 2002.**

##### **4(a) What progress has been made toward implementation of this service? When will the program be tested?**

The analysis of the major components of the business solutions are being analyzed and designed as part of the Milestone 3 phase of the project, and will be completed in July 2001. Detailed development and implementation plans for 2002 are being created and will be completed prior to exiting MS3. Negotiations are being conducted at this time for the testing part of the project.

Milestone 3, is one of the 5 decision points used for planning and managing work throughout the life cycle of a BSM project. The IRS uses a system called the Enterprise Life Cycle (ELC) to plan and manage work throughout BSM. The ELC establishes a set of repeatable processes and a system of reviews, checkpoints, and milestones that reduce the risks of system development. Every product in the ELC process must be reviewed, accepted and approved before it moves to the next milestone. There are several review processes and strict measurement criteria that help reduce risks and ensure even the smallest detail is not overlooked.

##### **4(b) Have the business and functional requirements of the refund application been developed?**

We expect to complete Milestone 3 design, including the development of business and functional requirements in July 2001. Milestone 3, is one of the 5 decision points used for planning and managing work throughout the life cycle of a BSM project, and, where the analysis of the major components of the business solutions are analyzed and designed.

##### **4(c) What security and privacy measures will be implemented to protect taxpayer privacy?**

Along with the security initiatives noted in 2(b), we are addressing security and privacy in the Business Systems Modernization effort. In the future, this effort will give taxpayers the ability to access Internet based refund status. Currently under development is the Security Technology Infrastructure Release (STIR), which will provide a standard platform for Web-based applications. The STIR design follows a rule-based architecture, which governs user access to information by controlling different data permissions for IRS employees, organizations with which IRS has a trusted relationship, and the public at large.

**4(d) How is the program being integrated into the IRS overall modernization plan?**

The Program is being integrated into the IRS overall modernization plan as part of one of the objectives of Customer Communications 2002. Through Internet Refund/Fact of Filing the project will provide a tax refund status information application to taxpayers via the Internet. This objective is being tracked through risks, issues and mitigation to ensure deployment for 2002.

This objective, as part of the CC2002 project is also part of the IRS Business Systems Modernization's Near-Term Sequencing and Release Planning; the 2002 release initiative; and the Enterprise Architecture with relationship and dependencies to peer projects (e.g. STIR) and to IRS legacy systems fully described.

## **5. Special Pay Provisions**

**The IRS Restructuring and Reform Act of 1998 (“IRS Reform Act”) provides the IRS with certain personnel flexibilities to bring in experts and revitalize the IRS workforce. These personnel flexibilities include, but are not limited to the following: (1) streamline critical pay authority for up to 40 individuals; (2) the ability to set the pay for certain critical pay provisions at levels higher than under prior law; and (3) the ability to offer recruitment, retention and relocation incentives (collectively referred to in this letter as “special pay provisions”).**

### **5(a) How many persons has the IRS hired under the IRS Reform Act special pay provisions?**

From the passage of the Act in July 1998 through April 25, 2001, IRS hired 29 Streamlined Critical Pay executives (of which 21 are currently on board). There is currently 1 executive pending final approval and 4 being reviewed for approval. (See Table 5-a)

### **5(b) How many have since left the IRS?**

As of April 25, 2001, eight executives have left the IRS.

### **5(c) What is the average tenure of these individuals?**

The average tenure of the executives who have departed is 17 months. Three of the executives were with the IRS for over two years with the longest being 29 months.

### **5(d) What difficulties does the IRS face in retaining these individuals? What is the IRS doing to retain and attract these individuals?**

The Streamlined Critical Pay authority was given to the IRS for a very specific purpose:

To enable the Commissioner to attract the extremely highly qualified and exceptional individuals needed to modernize the Service and improve its operations. This authority provides expanded personnel flexibilities, including the ability to offer higher salaries than are normally available with the Senior Executive Service and other options such as the payment of relocation expenses, which enables the Service to attract top level executives.

To attract critical pay executives, the IRS currently contracts with three executive search firms: Page-Wheatcroft, Korn-Ferry; and Foster Partners, an affiliate of KPMG.

The IRS has been quite successful in convincing a number of senior executives from the private sector that public service can be an important component of their career. Critical pay executives are attracted by:

- The chance to join the IRS during a key transitional period
- The opportunity to design and influence the changes that will dictate how the Service will operate well into the twenty first century
- Working with the top management team to change the entire organization to include creating the new organizational structure, redesigning business processes, modernizing business systems, and developing new balanced measures.
- The opportunity to modernize an organization on such a large scale. Modernizing the IRS impacts all IRS employees and all taxpayers.

This authority was not created to permanently retain these highly skilled, sought after employees. Nor was it meant to increase the number of senior executives in government service. Successful retention of these employees is not evaluated by length of time in service. Most critical pay employees are hired for very specific roles and to provide specialized skills at critical points in the modernization effort. (See question 5(f) below).

**5(e) For the persons who have left the IRS, please provide the position, rate of pay, recruitment, retention, and location, and other incentives given to such individuals.**

***LIST OF STREAMLINED CRITICAL PAY EXECUTIVES  
WHO HAVE LEFT THE IRS***

| <b>POSITION TITLE</b>  | <b>RATE OF PAY</b> | <b>INCENTIVES/BONUSES</b>                                | <b>DATES OF SERVICE</b> |
|--|--------------------|--|-------------------------|
| Chief Financial Officer  | \$147,500          | None   | 8/16/98 TO<br>6/29/99   |
| Director, Program Control Information Systems                                | \$130,000          | None   | 12/19/99 TO<br>6/03/00  |
| Assistant Commissioner (Management and Financial Systems) IS                 | \$135,000          | None   | 5/9/99 TO 8/01/00       |
| Director, Government Program Management Office, IS                           | \$160,000          | \$15,000<br>(Recruitment,<br>11/2/98)                    | 11/2/98 TO<br>8/01/00   |
| Director, Real Estate and Facilities Management, Agency-Wide Shared Services | \$176,300          | \$37,800<br>(Recruitment,<br>3/15/00)                    | 3/15/00 TO<br>7/31/00   |
| National Taxpayer Advocate   | \$144,800*         | \$15,000<br>(Recruitment,<br>9/1/98)<br>\$25,000 (Annual | 9/1/98 TO<br>10/10/00   |

|                                       |            |   |                       |
|---------------------------------------|------------|---|-----------------------|
|                                       |            | Performance,<br>1/18/01)  |                       |
| Deputy Commissioner/<br>Modernization | \$155,100* | \$25,000<br>(Recruitment,<br>9/6/98)<br>\$20,000 (Annual<br>Performance,<br>1/18/01)  | 9/6/98 TO<br>10/08/00 |
| Chief Information Officer             | \$181,400* | \$43,600<br>(Recruitment,<br>8/11/98)<br>\$25,000 (Annual<br>Performance,<br>1/16/01) | 8/11/98 TO<br>1/26/01 |

\*Salary at departure.

**5(f) What are the titles and job descriptions of the individuals hired under the IRS Reform Act's special pay provisions? What specific accomplishment has the IRS achieved that would not have been realized without the ability to hire these individuals using the special pay provisions? (See table 5-a)**

The streamlined Critical Pay executives had extremely successful careers prior to their government service and bring a wealth of knowledge and expertise to the Service that otherwise would not have been available. These executives make key and highly significant contributions to the successful operations of the Service based on the extensive range of skills and experience that they bring to the IRS from their diverse backgrounds as evidenced by the contributions of our most recent departing executives.

**Paul Cosgrave's** leadership and dedication have been crucial to the IRS. From 8/11/98 to 1/26/01 Mr. Cosgrave provided clear, creative strategic direction in both business and technology arenas helping us to successfully reach a number of key milestones in our efforts to modernize the nation's tax agency. Under Mr. Cosgrave's leadership the IRS:

- Created a consolidated nationwide IS organization, where nearly 100 percent of the IT resources are directed, in accordance with industry standards, by the Office of the CIO.
- Completed a nearly flawless Y2K conversion resulting in many areas of standardization and consolidation of our information systems operations
  - Consolidated an unwieldy collection of 11 different, independent e-mail systems into one consistent system, which has significantly improved our ability to communicate across the country
  - Consolidated the mainframe operations -- going from 67 different mainframes in 12 different locations to under 20 computers now centralized in our 3 computing centers. This will, over a period of years,

allow us to reinvest almost \$700 million of savings into our modernization activities

- Completed the IRS Enterprise Architecture, or Blueprint, which, for the first time, clearly defined how our business operations will be improved and how the IRS will take advantage of today's modern technology
- Established the Business Systems Modernization program, which is now well under way to replace IRS' outdated technology with modern systems

**Val Oveson** oversaw the transformation of the National Taxpayer Advocate's office to reflect the Restructuring and Reform Act. From 9/1/98 to 10/10/00 Mr. Oveson's leadership the National Taxpayer Advocate's office:

- Reported directly to the National Taxpayer Advocate for the first time. The move to this nationwide network added more independence
- Reorganized 74 Taxpayer Advocates as part of the Taxpayer Advocate Service (TAS). In all, TAS has more than 2,000 employees, including caseworkers, dedicated to helping taxpayers work out problems.
- Took on a greater role assisting taxpayers in tax disputes with the IRS, championing taxpayer's rights and providing recommendations for improving tax legislation.
- Prepared a new, expanded annual report to Congress. This report fills a unique niche at the IRS. The National Taxpayer Advocate office prepares its own independent summary of the 20 most serious problems encountered by taxpayers, legislative recommendations for improvements and assessments of IRS efforts to improve customer service and reduce taxpayer burden.

**John LaFaver** led the first major IRS reorganization since the 1950's. The redesigned organizational structure will be completed by October 2000. From 9/6/96 to 10/08/00 Mr. LaFaver:

- Oversaw the massive transformation of the IRS into the four new customer-based divisions
- Developed detailed organizational designs for the 11 organizational units and the national headquarters organization.
- Determined a staffing and selection strategy for the operating divisions.
- Developed and implemented transition planning in the new organization.
- Assumed a leadership role in the Tax Administration Visioning project – a key element in defining the future Business Systems Modernization Program

The Service has recruited an exceptionally talented and experienced workforce to provide vision, leadership and guidance which, supplemented by the experience and skills of the career executive corps, has enabled the Service to successfully meet the massive challenges of the complete restructuring mandated by Congress. Our current critical pay executives bring external experiences, practices, and knowledge not currently available within the organization:

- The new Deputy Commissioner Modernization/Chief Information Officer was a top executive in the technology area at Time-Warner.

- Two of the four Division Commissioners and one of the Deputy Commissioners are external hires and provide specific industry background and experience, change management experience and senior leadership.
- All of the Senior Industry Advisors in the Large and Mid-Size Business Division have been recruited from the industries to which they are assigned making them uniquely suited to providing the most current technical advice to the Service.
- The new National Taxpayer Advocate had a long and distinguished career in tax advocacy and is well known in legal circles and in Congress.
- The Chief, Criminal Investigation is an attorney with a successful career at Justice and in private law practice.
- The Chief, Agency-Wide Shared Services was recruited from a major international corporation and brings to the agency commercial service support best practices.
- The Associate Commissioner for Business Systems Modernization was previously President of the Professional Services Council and joined the Service with a wealth of experience and background in modernizing systems.
- The new chief, Information Technology Services was just recruited from Marriott, International where he was Senior Vice President Information Research Operations and Services.
- The recent hire for Chief Business Strategist and Business Architecture in the Wage and Investment Division is one of the leading experts in the United States on designing and operating call centers.
- The Director, Stakeholder, Partnership, Education and Communications Office in the Wage and Investment Division came to the Service from Karch International where he was Chief Operating Officer and had directed a wide array of successful marketing projects.
- The Director International Operation in the Large and Midsize Division was formerly the Director, E-Business Tax Policy and Practices at PriceWaterhouseCoopers and had over 15 years of corporate international tax experience.

(Position descriptions are available upon request.)

**Table 5-a Critical Pay Executives  
Current and Pending (\*)**

| Business Unit   | V         | P        | OB        | Position Title  | Name             | Apptmt Date | Expiration Date |
|-----------------|-----------|----------|-----------|---|------------------|-------------|-----------------|
| AWSS            | 1         |          | 1         | Chief, Agencywide Shared Services                     | William Boswell  |             |                 |
|                 |           |          |           | Director of Facilities Operations                     | Vacant           |             |                 |
| BSMO            |           | 1        | 1         | Director, Business Systems Modernization              | Bert Concklin    |             | 6/13/00         |
|                 | 1         |          |           | Executive Program Advisor to BSMO                     | Fred Forman*     |             |                 |
|                 | 1         |          |           | Program Integration (Int. Mgt.)                       | Vacant           |             |                 |
| CIO             | 1         |          | 1         | Director, Program Management & Control                | Vacant           |             |                 |
|                 | 1         |          | 1         | Chief, Information Technology Services                | Jim Rinaldi      | 4/11/01     | 4/10/05         |
|                 |           |          |           | Director, Security Modernization                      | Vacant           |             |                 |
| C&L             |           | 1        | 1         | Project Director, WS, ID & CI                         | Jimi Stricklin*  |             |                 |
| CI              |           | 1        | 1         | Deputy Chief Communications and Liaison               | Delena Bratton*  |             |                 |
| LMSB            |           |          | 1         | Chief, Criminal Investigation                         | Mark Matthews    | 12/6/99     | 12/5/03         |
|                 |           |          | 1         | Commissioner, LMSB                                    | Larry Langdon    | 11/28/99    | 11/27/03        |
|                 |           |          | 1         | Director, International                               | Carol Dunahoo    | 5/1/00      | 4/30/04         |
|                 | 1         |          |           | Director, E-Commerce                                  | Vacant           |             |                 |
|                 |           |          | 1         | Sr Industry Advisor (Financial Services & Healthcare) | Paul Claytor     | 10/26/00    | 10/25/04        |
|                 |           |          | 1         | Sr Industry Advisor (Food, Retail & Pharmaceuticals)  | Kurt Meier       | 1/22/01     | 1/21/05         |
|                 |           |          | 1         | Sr Industry Advisor (Natural Resources Industry Grp)  | Doug Berg        | 8/28/00     | 8/27/04         |
|                 |           |          | 1         | Sr Industry Advisor (Communications, Tech & Media)    | Cliff Jernigan   | 4/3/01      | 4/2/05          |
|                 | 1         |          |           | Sr Industry Advisor (Manfctrg, Construction & Trans)  | Vacant           | 4/30/01     | 4/29/01         |
| NHQ             | 1         |          |           | Director, Strategy, Research & Prog Planning          | Vacant           |             |                 |
|                 |           |          | 1         | Deputy Commissioner, Modernization/CIO                | John Reece       | 3/5/01      | 3/4/05          |
| SB/SE           |           | 1        |           | Director, Research                                    | Eric Toder*      |             |                 |
|                 | 1         |          | 1         | Commissioner, SB/SE                                   | Joseph Kehoe     | 1/10/00     | 1/9/04          |
|                 | 1         |          |           | Special Assistant, Examination                        | Vacant           |             |                 |
|                 | 1         |          |           | Special Assistant, Collection                         | Vacant           |             |                 |
|                 |           |          | 1         | Director, Communications                              | Heather Rosenker | 10/19/00    | 10/18/04        |
| TAS             |           |          | 1         | Director, Partnership Outreach                        | Tom Dobbins      | 1/21/01     | 1/20/05         |
|                 |           |          | 1         | Taxpayer Advocate                                     | Nina Olson       | 3/1/01      |                 |
|                 | 1         |          |           | OD Taxpayer Advocate (W&I and TE/GE)                  | Vacant           |             |                 |
| TE/GE           | 1         |          |           | OD Taxpayer Advocate (SB/SE and LMSB)                 | Vacant           |             |                 |
|                 |           |          | 1         | Director, EP Rulings & Agreements                     | Paul Shultz      | 3/26/00     | 3/25/04         |
|                 |           |          | 1         | Director, EO Rulings & Agreements                     | Vacant           |             |                 |
| W&I             |           |          | 1         | Senior Technical Advisor to Division Commissioner     | Thomas Terry     | 3/12/01     | 3/11/05         |
|                 |           |          | 1         | Deputy Commissioner, W&I                              | John Duder       | 7/2/00      | 7/1/04          |
|                 |           |          | 1         | Director, Communications                              | Maureen Allen    | 1/21/01     | 1/20/05         |
|                 |           | 1        |           | Sr Tech Advisor (Customer Account Services)           | John Liuzzi*     |             |                 |
|                 |           |          | 1         | Chief Business Strategist and Business Architect      | Jim Ayres        | 4/6/01      | 4/5/05          |
|                 |           |          | 1         | Director, Stakeholder, Partnership & Education        | Mark Pursley     | 3/26/00     | 3/25/04         |
|                 | 1         |          |           | Director, Prod & Partnership Development              | Vacant           |             |                 |
|                 | 1         |          |           | Director, Joint Operations Center                     | Vacant           |             |                 |
| <b>Vacant</b>   | <b>14</b> |          |           |   |                  |             |                 |
| <b>Pending</b>  |           | <b>5</b> |           |   |                  |             |                 |
| <b>On-Board</b> |           |          | <b>21</b> |   |                  |             |                 |
| <b>Total</b>    |           |          | <b>40</b> |   |                  |             |                 |

40 Positions Available, 40 positions allocated (13 vacant).

\*Search Complete; Pending Approval

\*\*Bonus subject to maximum cap of \$186,300.

## **6. Other Personnel Issues**

**6(a) For the previous 12 months, please provide a summary of the IRS's use of the other IRS Reform Act personnel flexibility provisions (e.g., streamlined demonstration project authority, workforce classification and pay, performance management reforms, etc.) and update on the implementation of "Balanced Measures."**

### ***Workforce Classification and Pay:***

On March 25, 2001, IRS will convert the first employees into the Senior Manager Payband established under the Reform Act's workforce classification and pay authority (5 U.S.C. 5909). The new payband, covering employees in positions formerly classified at the GS-14 and GS-15 grade levels that cover second level managers or first level managers reporting directly to executives. These positions are found in all organizations within the Service, and they share similar responsibility for meeting the IRS mission. The pay range for these positions will be from the minimum rate for GS-14 to the maximum rate for GS-15. Advancement through the range will be based on biennial salary reviews considering performance as it is appraised under the new performance management system and the increasing difficulty of the position.

We are now developing a strategy to place most other non-bargaining unit positions in paybands. We envision separate bands for managers of single grade level positions and first level managers of dual grade level positions combined with some second level managers of lower grade employees and, finally, a band for senior management officials. In addition, we are developing paybands for all Information Systems employees, and for our criminal investigators (special agents). We hope to gain approval to proceed with these new initiatives early in the third quarter of this fiscal year.

### ***Performance Management:***

We have continued improvement of the Performance Management System for Executives, Managers and Management Officials, which was implemented in FY 2000 to more closely align individual performance with organizational success through the Business Planning process and balanced Measurement System. For Fiscal Year 2001, we incorporated leadership competencies into the performance expectations for executives and managers to facilitate alignment of the evaluations system with the systems for selection and development of organizational leaders.

In addition, we are currently negotiating with the National Treasury Employees Union over impact and implementation of new Critical Job Elements for employees that are aligned with our Balanced Measurement System. We anticipate implementation of the new CJE's in summer 2001.

**6(b) Section 1203 of the IRS Reform Act provides that IRS employees may be terminated for certain proven violations.**

**6(b)(1) How many employees have been terminated for each violation enumerated in section 1203?**

Please see attached spreadsheet

**6(b)(2) How many employees have been terminated for filing late returns that showed a tax refund due the employee?**

The response to this question is based only on cases submitted to the Section 1203 Review Board for evaluation. The data that was used to answer question 6(b)(1) does not identify whether the return was a refund or a balance due. The IRS collects this data only on cases submitted to the Section 1203 Review Board.

The Review Board may recommend to the Commissioner that the penalty be mitigated or, by deciding not to make a recommendation, may allow the removal penalty imposed by law to be carried out. As of December 31, 2000, we removed 7 employees for willful failure to timely file a Federal tax return involving a tax refund. This includes employees who resigned or retired after we submitted their case to the Review Board. If the Review Board did not recommend mitigation of penalty and the employee resigned or retired before we implemented the removal action, we count that case as a removal.

The following table reflects all 1203(b)(8) cases considered by the Review Board through December 31, 2000. An employee who did not file a return is assumed to have had a balance due.

| <b>Grade</b> | <b>Refund</b>  |                  | <b>Balance Due</b> |                  | <b>Total</b> |
|--------------|----------------|------------------|--------------------|------------------|--------------|
|              | <i>Removed</i> | <i>Mitigated</i> | <i>Removed</i>     | <i>Mitigated</i> |              |
| 2            | 0              | 0                | 1                  | 0                | 1            |
| 3            | 1              | 5                | 5                  | 1                | 12           |
| 4            | 2              | 7                | 2                  | 4                | 15           |
| 5            | 0              | 3                | 7                  | 2                | 12           |
| 6            | 1              | 2                | 7                  | 1                | 11           |
| 7            | 1              | 7                | 8                  | 2                | 18           |
| 8            | 0              | 2                | 3                  | 2                | 7            |
| 9            | 0              | 3                | 2                  | 1                | 6            |
| 10           | 0              | 0                | 0                  | 0                | 0            |
| 11           | 0              | 0                | 0                  | 2                | 2            |
| 12           | 1              | 1                | 0                  | 0                | 2            |
| 13           | 1              | 2                | 1                  | 0                | 4            |
| 14           | 0              | 1                | 0                  | 1                | 2            |
| 15           | 0              | 0                | 0                  | 0                | 0            |
| Executive    | 0              | 0                | 0                  | 0                | 0            |
| Wage Grade   | 0              | 1                | 0                  | 0                | 1            |
| <b>Total</b> | 7              | 34               | 36                 | 16               | 93           |

The following examples reflect the common fact patterns in Section 1203(b)(8) cases involving tax refunds:

Case 1-- A GS-3 file clerk, with nine years of IRS service at the time of the offense, filed a refund return six months late. Five months before the return was due, we suspended the employee for 14 days for a prior year's late filing and late payment, and for serious off-duty misconduct. The employee's significant disciplinary record for both tax and non-tax issues, combined with the fact that the discipline was imposed shortly before the current return was due, resulted in the Review Board decision not to recommend mitigation of penalty.

Case 2-- A GS-4 clerk with 7 years service at the time of the offense filed a refund return seven months after an extension of time to file lapsed, after receipt of a notice regarding his failure to file. He had been counseled for late filing TY 90 and 92. Audits of TY 94, 95 and 96 resulted in disallowed Earned Income Tax Credit and dependent claims. We offset the refund for TY 98 to meet some of this liability. The employee's failure to file until after receipt of a notice, combined with his tax compliance record resulted in a Review Board determination not to recommend mitigation of penalty.

Case 3--An employee with over 20 years service in tax law enforcement duties failed to timely file a refund return. The employee had a history of tax compliance discipline. When asked to explain why this return was not timely filed, the employee said the reasons were personal, and refused to elaborate. The Review Board did not recommend mitigation in this case.

**6(b)(3) Please describe the impact these provisions have had on the functioning of the IRS.**

We submitted the report at the end of this narrative to the Congress in June 2000. The report gives a detailed description of the IRS implementation of Section 1203, including statistics that were current at the time of the report. While we have more current statistics, the processes and issues described have not changed substantively. As the Commissioner states in his letter forwarding the June 2000 report, employees and managers expressed two main concerns about Section 1203. One was the fear that unfounded allegations of harassment and retaliation could cost them their jobs. We have been able to ease that concern through distribution of facts about actual case dispositions. We did not penalize employees Section 1203 for honest mistakes or on the basis of unfounded allegations.

The second concern cited by many employees and managers is the belief that the removal sanction for employee tax compliance violations (Section 1203(b)(8) and Section 1203(b)(9)) are too harsh in some cases. While a non-employee taxpayer will suffer no penalty for a late filed refund return (other than forfeiting the refund if the return is not filed within three years), an IRS employee is subject to removal. The perception of inequity is not limited to refund returns, but the disparity in treatment is

most obvious in those cases. Our distribution of information about the implementation of Section 1203 has increased employee and manager anxiety, as they see that the vast majority of cases are based on tax compliance.

The Commissioner has used his authority to mitigate the penalty in 50 of the 93 tax compliance cases that have been through the entire process established for Section 1203 cases. The mitigation of penalty decisions have reduced the impact of Section 1203 in cases where removal would be too harsh, but even these employees had to experience the potential of removal as their cases moved through the process.

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## **SUMMARY OF SECTION 1203**

### ***The Law***

Section 1203 of the IRS Restructuring and Reform Act of 1998 (P.L. 105-206) provides that the Commissioner of Internal Revenue shall terminate the employment of any employee if there is a final administrative or judicial determination that the employee committed any of 10 enumerated acts or omissions. The Commissioner has the authority to mitigate the penalty, but may not delegate this authority to any other officer. The Commissioner's determination on penalty, whether to remove or mitigate, may not be appealed in any administrative or judicial proceeding.

The penalty provisions of Section 1203 reflect the view that certain acts or omissions by IRS employees are intolerable, and the normal sanction for those offenses should be removal. Acts or omissions covered by Section 1203 are:

1. Willful failure to obtain required approval signatures on documents authorizing a seizure
2. Providing false statements under oath on a material matter involving a taxpayer or taxpayer's representative
3. Violation of the rights protected under the Constitution or six listed civil rights laws, of a taxpayer, taxpayer representative, or other employee of the IRS
4. Falsifying or destroying documents to conceal mistakes in a matter involving a taxpayer or taxpayer representative
5. Assault or battery on a taxpayer, taxpayer representative, or other employee of the IRS
6. Violations of the Internal Revenue Code, Treasury Regulations or IRS policy to retaliate against or harass a taxpayer, taxpayer representative, or other employee of the IRS
7. Willful misuse of the provisions of Section 6103 of the Internal Revenue Code for the purpose of concealing information from a congressional inquiry
8. Willful failure to file any Federal tax return as required by law, unless the failure is due to reasonable cause and not to willful neglect
9. Willful understatement of Federal tax liability, unless the understatement is due to reasonable cause and not to willful neglect

10. Threatening to audit a taxpayer for the purpose of extracting personal gain or benefit

(The full text of Section 1203 is attached as Appendix 1)

### ***Willfulness Criteria***

Each of the ten offenses under Section 1203 includes an element of intent. The IRS has emphasized that simple mistakes and unintentional errors made in good faith are not Section 1203 violations. For example, intent for Section 1203(b)(1) is shown when the employee has actual knowledge or acts with reckless disregard of the requirements to obtain required approval signatures before proceeding with a seizure. For Section 1203(b)(8), the employee's failure to file a Federal tax return as required by law must reflect the voluntary intentional violation of a known legal duty for which there is no reasonable cause. The IRS included definitions of willfulness and intent in the "RRA '98 Section 1203 Procedural Handbook," (Document 11043 (5/99)). An extract from that document, which we distributed to all employees, is enclosed as Appendix 2.

### ***Standards Are Not New***

The conduct addressed in Section 1203 has always been regarded as serious misconduct. What has changed is the penalty imposed for violations. Prior to the enactment of Section 1203, the general rules for imposing discipline required a deciding official to consider a wide range of factors in arriving at the appropriate penalty. These factors include the nature and seriousness of the offense, the employee's work record, the notoriety of the offense, and the impact of the offense on confidence in the employee's ability to perform his/her duties. When managers applied these factors to specific cases, they could impose a range of penalties. Section 1203 eliminated the variation in penalty, unless the Commissioner of Internal Revenue personally decides to reduce the penalty from removal to some lesser sanction.

While the general statement that the conduct covered by Section 1203 was always regarded as serious misconduct is true, in one area Section 1203 has changed the significance of an offense. Prior to Section 1203, the IRS viewed untimely payment of Federal tax liability as a more serious offense than late submission of a return. We regarded late payment of a balance due as serious misconduct, depending on the amount due and the degree to which the payment was overdue. We did not treat a return filed late with a minimal balance due, or a refund return, as a serious offense. Section 1203 does not address late payment, but makes all willful late filing a removal offense.

## **IMPLEMENTATION OF THE LAW**

### ***Procedural Guidance***

We recognized that Section 1203 reflected a renewed emphasis on employee conduct issues, and that employees needed a clear statement from management on the impact of the law on their daily work. Guidance for employees has taken many forms—memoranda, voice mail messages from the Commissioner and Deputy Commissioner for Operations, a procedural handbook and training guides. A chronology of the procedural guidance appears as in a table below, under “Training and Outreach.”

The most important procedural guidance is contained in “RRA ’98 Section 1203 Procedural Handbook” (Document 11043, 5/99). The Handbook contains an all-employees memorandum from the Commissioner, an overview of Section 1203 and the implementing procedures, plain language definitions of “intent” and “willfulness,” and detailed procedures. The procedures are designed to ensure that each allegation of a Section 1203 violation is dealt with in a manner that protects the rights of the employee accused of the violation as well as those of the accuser.

### ***Training and Outreach***

The IRS emphasized the importance of Section 1203 through training for all employees, as well as through special training for managers and labor relations specialists on their responsibilities under the law. Initially we conducted all employee training, involving in-person classes for about 100,000 employees, beginning in late 1998 and early 1999. After feedback and numerous focus group interviews indicated that employees were still uncertain about their rights, responsibilities, and risks under the law, and that the initial training had created unnecessarily inflated fears, we revised the training and conducted a new round of training in May 1999.

Outreach to employees began with the enactment of Section 1203, and continues to this day. I and other senior executives take questions from employees during “town hall” meetings as we travel around the country, and Section 1203 is usually a topic in these discussions. A page on the IRS intranet is devoted to Section 1203, including frequently asked questions. The intranet page also provides sample case scenarios to illustrate the application of the tax compliance provisions, which account for almost all of the removals under Section 1203. In addition, a March 2000 conference of front line Collection managers included presentations on Section 1203 from several IRS senior executives and the Treasury Inspector General for Tax Administration.

A list of the major training and outreach publications and events appears in the table below. The publications emphasize that employees are not at risk of removal for conscientiously performing their duties, even if they make a mistake in doing so. Section 1203 only addresses willful and intentional misconduct.

**Table 1: Training and Outreach Publications and Events**

**July 1998 to April 2000**

|                           |  |
|---------------------------|--|
| July 1998                 | Highlights of the Restructuring and Reform Act of 1998, " <i>Significant Issues Effective Upon Date of Enactment</i> ", Document 10829 |
| August 1998               | Labor Relations Continuing Professional Education on Restructuring and Reform '98 Conduct Provisions                                   |
| September 1998            | Memorandum for All Employees: "IRS Restructuring and Reform Act of 1998 Conduct Provisions"  |
|                           | IRS Restructuring and Reform Act of 1998 (RRA '98) Conduct Provisions " <i>Employee's Guide</i> ", Document 10848                      |
| October 1998              | Interactive Video Teletraining for Heads of Office and Executives  |
|                           | Restructuring and Reform Act of 1998, Title I §1203 Process Overview, " <i>Instructor's Guide</i> "                                    |
|                           | IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, " <i>Instructor's Guide</i> ", Training 9990-103                |
|                           | IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, " <i>Employee's Participant Guide</i> ", Training 9990-102      |
|                           | IRS Restructuring and Reform Act of 1998, §1203(b) Conduct Provisions, " <i>Manager's Participant Guide</i> ", Training 9990-101       |
| December 1998             | <u>STRAIGHT TALK NEWSLETTER</u> : "Title I: IRS embarks on training," including training on Section 1203                               |
| January and February 1999 | All Employees Briefings on Section 1203  |
| February 1999             | <u>STRAIGHT TALK NEWSLETTER</u> : Question and Answer on "quotas" for Section 1203 discipline  |
|                           | Memorandum for All Employees: "Employee Tax Compliance Obligations"  |
|                           | Section 1203 Training Implementation Plan  |
| March 1999                | Memorandum for All Employees: "Section 1203 (Termination of Employment for Misconduct) Training and Communication"                     |
|                           | <u>What you Need to Know About Section 1230</u> , Tri-fold publication, Document 10997; included with paychecks                        |

|                    |  |
|--------------------|--|
| April and May 1999 | All Employees Briefings on Section 1203  |
|                    | <i>"RRA '98 Section 1203 Resource Guide"</i> , Document 11042  |
|                    | <i>"RRA '98 Section 1203 Procedural Handbook"</i> , Document 11043   |
|                    | Procedures for Processing Allegations for §1203 Violations (for Labor Relations Staff)   |
|                    | <u><i>STRAIGHT TALK NEWSLETTER</i></u> : Announcing opportunity for public comment on Section 1203 regulations   |
| July 1999          | Video Broadcast of Commissioner meeting with Virginia-West Virginia District managers question and answer session  |
| September 1999     | All Employee Memorandum from Commissioner "Report on Actions Concerning Misconduct Allegations and Disciplinary Actions" provided Section 1203 statistics and summary case information                     |
|                    | <u><i>STRAIGHT TALK NEWSLETTER</i></u> : Announcing availability of All Employee Memorandum, and providing Section 1203 Questions and Answers  |
| January 2000       | <u><i>STRAIGHT TALK NEWSLETTER</i></u> : Announcing availability of data on Section 1203 allegations and disciplinary actions  |
| March 2000         | Meeting of first-level Collection managers, to discuss the importance of their work and their role in the new IRS organization. Included presentations by TIGTA and IRS executives on Section 1203 issues. |
|                    | <u><i>STRAIGHT TALK NEWSLETTER</i></u> : Describing results of meeting with Collection managers, including discussion of Section 1203  |
| April 2000         | <u><i>STRAIGHT TALK NEWSLETTER</i></u> : Describes actions needed to address taxable local travel reimbursements, and the impact of Section 1203 on corrected Federal tax returns                          |
|                    | <u><i>IRS Headlines Voice Message</i></u> : A reminder to file Federal tax returns timely to avoid a Section 1203 violation  |

## **ACTING ON SECTION 1203 ALLEGATIONS**

### ***Life Cycle of an Allegation***

An allegation of a violation of Section 1203 must go through five stages before we remove an employee. These include:

- Receipt and initial analysis
- Inquiry or investigation
- Evaluation
- Local disciplinary processes
- National Office review

Tax compliance issues normally arise through the Employee Tax Compliance program, and are addressed separately below. Appendix 3 contains a general process flowchart, as well as specific flowcharts for particular provisions of Section 1203.

### **Receipt and Initial Analysis**

A Section 1203 allegation may be made to the Treasury Inspector General for Tax Administration (TIGTA), or to any employee of the IRS. In some cases, an employee accused of misconduct by a taxpayer self-reports the allegation to a supervisor or the TIGTA. Regardless of who receives the allegation, the first step is to evaluate the allegation to determine whether it should be pursued as a Section 1203 matter.

Division-level management or above evaluate allegations under Subsections (b)(1), related to seizures, (b)(3)(A), related to Constitutional rights, and (b)(6), related to harassment or retaliation, to determine whether the threshold established in the law has been met. For example, Subsection 1203(b)(6) addresses violations of the Internal Revenue Code, Treasury regulations, or IRS policies for the purpose of retaliating against or harassing a taxpayer, taxpayer representative, or other employee of the IRS. The initial analysis of such an allegation would be done by Division-level management, to determine whether there was a violation of the Internal Revenue Code, Treasury regulations, or IRS policy. If we found a violation of the Internal Revenue Code, Treasury regulations, or IRS policy, we investigate the allegation to determine whether there was an intent to retaliate or harass.

Subsection (b)(3)(B) provides that a violation of one of six Civil Rights statutes is covered by the mandatory termination of employment provisions of Section 1203. Violations of these statutes with respect to a fellow IRS employee are also covered by the Equal Employment Opportunity program, which includes processes for an employee to seek relief from discrimination. Upon the

completion of Equal Employment Opportunity program process, whatever the outcome may be for the employee seeking relief, a special unit reporting to the National Director, Equal Employment Opportunity and Diversity, reviews the file to determine whether the matter warrants a referral for investigation under Section 1203.

The TIGTA performs the initial analysis of alleged violations of the remaining non-tax provisions of section 1203. Any IRS employee receiving such an allegation must refer it immediately to the TIGTA. In addition, any allegation of criminal misconduct is immediately referred to the TIGTA, as are allegations against managers, GS-15s, Senior Executives and Criminal Investigations employees.

### **Inquiry or Investigation**

The TIGTA has primary responsibility for investigations of allegations under Section 1203. TIGTA special agents conduct these investigations, and report the results the IRS for evaluation. In some cases, facts developed during the initial analysis of an allegation are sufficient to resolve the matter. For example, the initial analysis may establish that an employee violated IRS policy by acting unprofessionally in dealing with a taxpayer. The information necessary to establish that the employee acted unprofessionally may also be sufficient to establish that the behavior was not intended as an act of retaliation or harassment, and the matter may be dealt with as a non-1203 misconduct or performance matter.

### **Evaluation**

Once IRS management established the facts through an inquiry or investigation, they must evaluate the information to determine whether a violation of Section 1203 has occurred. A Division-level or above manager, with the assistance of local labor relations specialists and the staff of the Centralized Adjudication Unit (CAU) makes this decision. The CAU participates in all determinations under Section 1203, to ensure consistency throughout the IRS.

Evaluation of the results of the investigation or inquiry may lead to a finding that:

- No misconduct occurred
- Insufficient evidence exists to prove misconduct
- Sufficient evidence exists to charge non-1203 misconduct
- Sufficient evidence exists to charge 1203 misconduct.

A finding of no misconduct, or of insufficient evidence to prove misconduct, results in a “clearance letter” or a “closed without action letter,” respectively. A finding of non-1203 misconduct results in discipline under regular disciplinary procedures. Depending on the nature of the misconduct, the employee’s work

record, and other factors, the discipline could range from informal counseling to termination of employment. A finding of sufficient evidence to support a 1203 charge results in local disciplinary action under Section 1203 procedures.

### **Local Disciplinary Processes Under Section 1203 Procedures**

When Division-level management or above finds sufficient evidence to charge under Section 1203, they give the employee a letter advising that the IRS proposes to remove him or her from the Federal service. The employee has a right to respond to the proposal letter, and may do so orally or in writing. Many bargaining unit employees exercise their right to representation by the NTEU at an oral reply. After the reply, a deciding official determines whether the 1203 charge has been sustained by a preponderance of the evidence. This factual determination is reviewable through arbitration or an appeal to the Merit System Protection Board. If the deciding official determines that the 1203 charge is sustained, the case file is forwarded to the National Office for consideration by the Section 1203 Review Board.

### **National Office Review**

The Section 1203 Review Board examines all cases in which a 1203 charge has been sustained to determine whether a penalty less than termination of employment may be appropriate. The current Review Board members are the Deputy Commissioner for Operations, who serves as Chairman, the Assistant Deputy Commissioner for Operations, the National Director, Equal Employment Opportunity and Diversity, and the Regional Commissioner for the Western Region. The Centralized Adjudication Unit assembles the case files, and a representative of the Office of Chief Counsel attends and participates in all Review Board meetings.

The Review Board submits recommendations for mitigation of penalty to the Commissioner of Internal Revenue for decision. If the Review Board does not recommend mitigation of the penalty, they do not submit the case to the Commissioner and the statutory penalty of removal is imposed. After National Office review, all case files are returned to the local management official for notification to the employee and implementation of the decision.

### ***Processing Tax Compliance Cases***

The Employee Tax Compliance Program generally identifies potential violations of the two tax compliance provisions of Section 1203. They match computer files identifying IRS employees against tax administration files to find employees who appear to have tax compliance problems. If inquiries from the Employee Tax Compliance Unit do not resolve the matter, they forward the case to local management for action. Cases involving apparent willful failure to timely file a

Federal tax return or apparent willful underreporting of income are flagged as potential 1203 (b)(8) and (b)(9) cases, respectively. The process described above is then followed, except that IRS management conducts the fact finding inquiry rather than the TIGTA.

## **STATISTICS AND CASE EXAMPLES**

### ***Allegations Received, Investigated and Resolved***

The statistics on Section 1203 indicate that allegations of violation of law or policy for the purpose of retaliation and harassment under subsection (b)(6) are the most common, but very few of those allegations are substantiated. Employee tax compliance cases based on willful failure to timely file account for the next largest group of cases, and most of the substantiated cases.

Data in the following tables show the number of allegations received by the TIGTA and the allegations received by the IRS. The numbers should not be added. Allegations received by the TIGTA include some matters referred by the IRS, which would also be counted in the IRS numbers. There is also a large number of reporting offices contributing to these statistics. We know that some IRS offices were very conservative in counting potential 1203 allegations, including in their count matters that other offices did not. For example, we do not believe Section 1203 was intended to cover routine workplace disputes between employees and their managers. Nevertheless, we understand that some offices reported potential 1203 (b)(6) retaliation or harassment cases based on the use of either word in an employee grievance. Others did not include these harassment claims unless they appeared to be more than an aggressive pleading in an otherwise routine grievance.

**Table 2: 1203 Allegations Received and Investigated**

**July 1998 to May 2000**

| <b>Allegation Type</b>                           | <b>TIGTA Receipts*</b> | <b>IRS Receipts*</b> | <b>Investigations or Inquiries Completed</b> | <b>Substantiated Violations of Section 1203**</b> |
|--|------------------------|----------------------|--|---|
| Seizure Without Approvals (b)(1)                 | 14                     | 8                    | 7  | 0   |
| False Statement Under Oath (b)(2)                | 15                     | 8                    | 5  | 0   |
| Constitutional or Civil Rights Violation (b)(3)  | 169                    | 193                  | 170  | 0   |
| Falsifying or Destroying Records (b)(4)          | 38                     | 46                   | 24   | 1   |
| Assault or Battery (b)(5)                        | 0                      | 7                    | 3  | 0   |
| Retaliate or Harass (b)(6)                       | 399                    | 990                  | 830  | 0   |
| Misuse of 6103 (b)(7)                            | 0                      | 3                    | 3  | 0   |
| Failure to Timely File Federal Tax Return (b)(8) | 5                      | 443                  | 256  | 102   |
| Understatement of Federal Tax Liability (b)(9)   | 30                     | 31                   | 15   | 2   |
| Threat to Audit For Personal Gain (b)(10)        | 13                     | 52                   | 36   | 4   |
| <b>Total</b>                                     | <b>683*</b>            | <b>1781*</b>         | <b>1349</b>                                  | <b>109</b>  |

\*The TIGTA refers most of the allegations they receive to the IRS for action, either as a report of investigation or a referral for a management inquiry. The numbers in these columns should not be added.

\*\*Allegations are considered "substantiated" if the TIGTA investigation or management inquiry develops information sufficient to support the allegation. As the case is considered at various stages of the discipline process, additional information may be developed that results in a finding that there was not a violation of Section 1203. The numbers that appear in this column are adjusted to reflect the most recent information available.

Some allegations reveal improper conduct or poor performance that is not within the scope of Section 1203. For example, approximately 40 complaints considered under section 1203(b)(6) as potential harassment or retaliation resulted in discipline for unprofessional conduct. Several of these cases are described in the case examples that appear after the next table.

**Removals Under Section 1203**

The 109 substantiated Section 1203 violations cited above include all cases in which a TIGTA investigation or management inquiry resulted in a finding of sufficient evidence to support a Section 1203 charge. If an employee presents information in response to a proposed removal that refutes the charge, the case is no longer counted as a substantiated 1203 allegation.

We do not remove an employee under Section 1203 until the Section 1203 Review Board considers his or her. Some employees elect to resign or retire before the case completes this process, and a small number are removed under other authorities, such as termination of employment during probation. The table below reflects the current status of the substantiated Section 1203 allegations.

**Table 3: Status of Substantiated 1203 Allegations**

**As of May 16, 2000**

|  | Failure to Timely File Federal Tax Return (b)(8) | Other Provision of §1203 |
|--|--|--------------------------|
| Removals   | 26   | 2                        |
| Employee Separated From IRS By Resignation, Retirement, or non-1203 Action | 26   | 1                        |
| Case In Process  | 50*  | 4                        |
| <b>Total</b>   | <b>102</b>                                       | <b>7</b>                 |

\* Of the 50 cases in process, the Review Board has considered 10. At its May 2000 meeting, the Review Board has concluded that it will recommend mitigation of penalty to something less than removal. The Review Board deferred action on specific recommendations on the level of discipline until its June 2000 meeting.

## **Case Examples**

The following examples illustrate the common fact patterns in Section 1203 cases. The definition of “willful” under the Subsection 1203(b)(8) is the voluntary intentional violation of a known legal duty, for which there is no reasonable cause. Thus, these case examples include information about the employee’s knowledge of his or her responsibilities, including the briefings the employee may have received on those responsibilities.

### **Case 1 Section 1203(b)(8) Timely File Federal Tax Return----Removal**

The employee was appointed to her position on February 4, 1996. She acknowledged receipt of the IRS Rules of Conduct on that date, and acknowledged receipt of the OGE Standards of Ethical Conduct on February 18, 1997. She had been reminded annually by the Service Center Director, via an All Employee memorandum, of her obligations to file her Federal income tax return, accurately report income, and pay tax due as required by law.

The employee was a GS-3 Clerk at the time of the violation. She did not file her 1996 Federal income tax return until March 23, 1999, and only after managerial intervention, and three notices from the Service Center. The return reflected a balance due. She attributed the filing delay to a difficult pregnancy, however, provided no medical evidence in support of her contention that the condition precluded her from meeting her tax compliance obligations. Accordingly, the Review Board found her failure to file to be attributable willful neglect, and not to reasonable cause.

### **Case 2 Section 1203(b)(8) Timely File Federal Tax Return----Removal**

The employee did not file her 1996 Federal income tax return until October 9, 1998. She was a GS-4 Mail Clerk at the time of the violation. The employee stated she did not file the return because it required payment of taxes and she did not have the funds available at the time it was due. All employees of the organization are reminded yearly of their tax compliance obligation. The employee did not offer a valid explanation for her late filing and had not applied for a filing extension. Accordingly, the Review Board decided the employee’s tax non-compliance was willful.

### **Case 3 Section 1203(b)(10) Threat to Audit For Personal Gain----Removal**

The employee was identified as the driver of a vehicle involved in a hit and run accident. He was subsequently arrested for driving while intoxicated and leaving the scene of an accident. While in custody, the employee identified himself as an IRS employee and declared that he would “find out” about the arresting officer, and would have “a good time” with him. The employee’s assertion that his judgment was impaired due to intoxication, was not accepted. He had not only been able to drive home without further incident following the accident, but also responded coherently to the arresting officer’s questions, and engaged him in

conversation. Although the employee did not specifically use the word “audit,” his remarks to the arresting officer were clearly interpreted as such, and were made for personal gain.

#### Case 4 Section 1203(b)(8) Timely File Federal Tax Return----Removal

The employee was a GS-9 Revenue Officer, employed with the IRS for five years. The employee acknowledged receipt of IRS Interim Handbook of Employee Conduct and Ethical Behavior on two occasions (shortly after her appointment in 1995, and again in June 1998). The handbook specifically addresses employee tax obligations. Additionally, the employee's District Director issued an annual memorandum to all employees, reminding them of their tax obligations and responsibilities.

The employee received a counseling letter in February 1996 regarding the late filing of her 1993 Federal tax return. Despite the counseling, she again failed to file her return timely for tax year 1997. The employee raised unfamiliarity with “extension to file” provisions, and a missing/inaccurate Form 1099, as defense. Evidence proved neither claim was creditable. Accordingly, the Review Board decided the employee's tax non-compliance was willful.

#### Case 5 Section 1203(b)(8) Timely File Federal Tax Return----Not Willful, Other Disciplinary Action

The employee, a GS-4 Clerk, filed her 1997 tax return on January 20, 1999. The employee identified and raised the non-compliance. Shortly after attending a Section 1203 training session, the employee notified her supervisor of the matter. She learned in the training session that ALL returns must be filed timely. She advised her supervisor that for the past several years, she had not filed timely because she had always been entitled to a refund (this was subsequently corroborated). At no time prior to the training session had the IRS notified her of a non-compliance matter. She acknowledged that she now fully understands her filing obligations and would ensure that they are met in the future. Accordingly, the Review Board found the non-compliance was not willful and recommended mitigation of the removal penalty.

#### Case 6 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate----Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

A taxpayer representative alleged that a revenue agent used a hostile approach in conducting an audit, appearing to have reached conclusions before the audit started. A management inquiry found that the revenue agent speculated about the potential outcome of the audit and the consequences of such an outcome, but was not harassing the representative. Management counseled the revenue agent that speculation is inappropriate.

Case 7 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate----Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

A taxpayer complained that a revenue agent's information request was an effort to intimidate the taxpayer. A management inquiry found the revenue agent issued a 25 page request to the taxpayer, most of which was legal references. The revenue agent explained that he was attempting to document the legal support for the Government's position, and was not attempting to intimidate the taxpayer. Management counseled the revenue agent for demonstrating poor judgement.

Case 8 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate----Not Substantiated as 1203 violation, Counseled for Unprofessional Conduct

An employee was accused of harassment of a fellow employee, which involved spreading rumors about the fellow employee's military record. Management counseled the employee for causing dissension and discord in the workplace.

Case 9 Section 1203(b)(6) Violation of law or procedure to Harass and Retaliate----Not Substantiated as 1203 violation, Letter of Reprimand for Unprofessional Conduct

During a continuing professional education class, the employee questioned a guest speaker about a case both had worked on. The guest speaker had reversed the employee's action on the case. After the class session concluded, the employee again confronted the speaker about the case, and got within inches of the speaker's face. The speaker reported that he thought the employee was going to strike him. Management proposed a three day suspension for unprofessional conduct, which was reduced by the deciding official to a one day suspension. The employee grieved the suspension, and the case was settled with a reprimand.

## **CONCERNS RAISED BY EMPLOYEES AND MANAGERS**

### ***General Concerns***

When the Congress enacted Section 1203, the initial reaction from employees and managers was confusion and concern. RRA'98 modified many of the rules for dealing with taxpayers and taxpayer representatives, and it took some time before we could distribute definitive guidance and our front-line employees could absorb the information. Many comments focused on the changing expectations, and reflected concerns that employees could be removed for violating rules they did not understand. Training and procedural guidance on new tax administration rules and on Section 1203 have addressed some of these issues, although the

vast size and number of changes in IRS procedures cause continuing anxiety and uncertainty among employees and managers. This concern is closely related to concerns about section 1203 because some of the section 1203 offenses refer to IRS policy or procedure. The Internal Revenue Manual, which is the principal document for defining IRS policy and procedure, exceeds 50,000 pages and is constantly changing. In conditions of uncertainty and anxiety, it is sometimes viewed as the safest course to take no action or to take action very slowly.

### ***Specific Concerns***

Two persistent themes in employee and manager feedback regarding Section 1203 remain. The first is that the fear of a Section 1203 allegation discourages proper action by an IRS employee; the second is that the IRS subjects employees to unduly severe penalties for certain tax offenses.

#### **“The Fear of Section 1203 Allegations Discourages Proper Actions”**

The most common allegation under Section 1203 is that an employee has violated the Internal Revenue Code, Treasury Regulations or IRS policy for the purpose of retaliating against or harassing a taxpayer, taxpayer representative, or other IRS employee (1203(b)(6)). Many employees believe this provision encourages taxpayers and their representatives to make unfounded claims when the employee is simply doing his or her job. IRS managers raise similar concerns about employees who claim harassment or retaliation when a manager takes proper action to correct conduct or performance problems.

The fear of being the subject of a 1203 complaint and the subsequent investigation, even if the complaint is eventually not substantiated, is frequently cited by employees and managers as a major concern in their everyday work. Our data provides some support for the perception that significant numbers of unsubstantiated complaints trigger investigations. The IRS and the TIGTA have completed 830 inquiries or investigations under 1203 (b)(6). About 40 of these allegations involved some lapses in professional behavior, but none was substantiated as a 1203 violation and the vast majority, over 95%, involved no misconduct.

The IRS has not conducted a comprehensive review of the unsubstantiated allegations, but the staff who deal with the allegations on a daily basis report many allegations fit the patterns cited by employees and managers. Common fact patterns include:

- Taxpayers who claim harassment after receipt of a series of proper notices of tax delinquency
- Taxpayers who claim that the routine enforcement of the Internal Revenue Code is unconstitutional

- Employees who claim harassment or retaliation when relief sought through a grievance or Equal Employment Opportunity complaint is denied

Some of the complaints under 1203(b)(6) can be readily dismissed as unfounded, but many cannot. The inquiry and analysis called for in the 1203 procedures is designed to establish the relevant facts, and enable managers to make a fact-based determination about the allegation. The need to conduct a careful investigation also means that cases stay open for a considerable period of time. Employees cite the anxiety of this period when they know an allegation has been made but they have not been advised of the findings.

The IRS has attempted to deal with employee and manager concerns about the impact of unfounded allegations by publicizing the results of the inquiries, including the low number of substantiated cases. In addition, the IRS re-emphasized the importance of timely feedback to employees who are the subject of a specific allegation on the findings of the TIGTA investigation or management inquiry. We have also stressed the fact that complaints and allegations would have to be investigated regardless of the specific provisions of Section 1203.

#### “The Tax Compliance Provisions Impose Excessively Severe Penalties In Some Cases”

The employee tax compliance provisions of Section 1203 cause concern for employees and managers who believe the sanction imposed is too severe in some cases. IRS employees and taxpayers know that they must file an accurate return and pay their taxes on time, and that failure to do so can result in penalties, as this has been longstanding policy. However, the concern arises because of the Section 1203 requirement to remove an employee on the first offense in situations where non-IRS taxpayers would face little or no punishment.

The clearest example of this severity of treatment is in cases involving failure to file a refund return on time. A non-employee taxpayer who fails to file a refund return on time may forfeit the refund if the return is not filed within three years of the due date, but will otherwise suffer no penalty. An IRS employee is subject to removal on the first such offense. While the Commissioner can reduce the penalty in a circumstance such as this, the employee is subject to the threat of removal and an extended period of uncertainty while the case is processed.

Similar considerations sometimes apply when an employee with no prior tax compliance problems files a late balance due return. Some of the cases considered as potential Section 1203 violations involve relatively short periods of delinquency and relatively small amounts due. A non-employee taxpayer would be subject to a late filing penalty of up to 25% of the balance due, plus interest. For a late filed return with a \$2,000 balance due, the late filing penalty for a non-employee taxpayer is \$500 penalty, plus interest and an estimated tax penalty.

The employee bears the same penalties and interest sanctions, and loss of his or her job.

We have tried to address the concerns over the tax provisions of section 1203 by stressing that RRA 98 only requires termination if the employee cannot show reasonable cause, and also by exercising our authority to mitigate the penalty when termination is excessively harsh under the circumstances.

## **APPENDICES**

- 1. *Section 1203 of RRA '98***
- 2. *IRS Definitions of "Willful"***
- 3. *Flowcharts***

# Summary of §1203 Allegations Recorded In ALERTS as of March 31, 2001

| 1203 Violation                          | 1203 Section | Completed Inquiries | Inquiry In Progress | 1203 Inquiry Deferred | Total        |
|---|--------------|---------------------|---------------------|-----------------------|--------------|
| Seizure Without Approval                | (b)(1)       | 11                  | 2                   | 0                     | 13           |
| False Statement Under Oath              | (b)(2)       | 13                  | 3                   | 1                     | 17           |
| Constitutional & Civil Rights Issues    | (b)(3)       | 198                 | 18                  | 3                     | 219          |
| Falsifying or Destroying Records        | (b)(4)       | 45                  | 11                  | 6                     | 62           |
| Assault or Battery                      | (b)(5)       | 6                   | 1                   | 1                     | 8            |
| Retaliate or Harass                     | (b)(6)       | 1,285               | 119                 | 10                    | 1,414        |
| Misuse of 6103                          | (b)(7)       | 2                   | 0                   | 0                     | 2            |
| Failure to File Federal Tax Return      | (b)(8)       | 535                 | 229                 | 9                     | 773          |
| Understatement of Federal Tax Liability | (b)(9)       | 76                  | 111                 | 2                     | 189          |
| Threat to Audit for Personal Gain       | (b)(10)      | 48                  | 8                   | 0                     | 56           |
| <b>Totals</b>                           |              | <b>2,219</b>        | <b>502</b>          | <b>32</b>             | <b>2,753</b> |

**Notes:**

1. This report includes all §1203 allegations recorded in ALERTS since enactment of the IRS Restructuring and Reform Act of 1998 (July 1998).
2. 1203 Inquiry Deferred = Inquiry was not completed to determine if §1203 was violated (e.g., Employee resigned before an inquiry could be completed).
3. CCPAG received and forwarded to the Frivolous Return Program 588 taxpayer complaints alleging §1203 issues based on the constitutionality of the nation's tax laws. These complaints were not recorded in ALERTS and are not reflected in the attached tables.
4. Data from the Office of EEO & Diversity involving allegations of discrimination (§1203(b)(3)(B)) is not included in the tables.

## Summary of Completed §1203 Inquiries Recorded In ALERTS as of March 31, 2001

| 1203 Violation                          | 1203 Section | Substantiated Misconduct |                     | Allegation Not Substantiated | Total        |
|---|--------------|--------------------------|---------------------|------------------------------|--------------|
|   |              | 1203 Misconduct          | Non-1203 Misconduct |                              |              |
| Seizure Without Approval                | (b)(1)       | 0                        | 2                   | 9                            | 11           |
| False Statement Under Oath              | (b)(2)       | 2                        | 0                   | 11                           | 13           |
| Constitutional & Civil Rights Issues    | (b)(3)       | 0                        | 7                   | 191                          | 198          |
| Falsifying or Destroying Records        | (b)(4)       | 8                        | 13                  | 24                           | 45           |
| Assault or Battery                      | (b)(5)       | 0                        | 4                   | 2                            | 6            |
| Retaliate or Harass                     | (b)(6)       | 7                        | 80                  | 1,198                        | 1,285        |
| Misuse of 6103                          | (b)(7)       | 0                        | 0                   | 2                            | 2            |
| Failure to File Federal Tax Return      | (b)(8)       | 213                      | 189                 | 133                          | 535          |
| Understatement of Federal Tax Liability | (b)(9)       | 3                        | 32                  | 41                           | 76           |
| Threat to Audit for Personal Gain       | (b)(10)      | 10                       | 13                  | 25                           | 48           |
| <b>Totals</b>                           |              | <b>243</b>               | <b>340</b>          | <b>1,636</b>                 | <b>2,219</b> |

Source: Automated Labor and Employee Relations Tracking System (ALERTS).

# Summary of Substantiated §1203 Allegations Recorded In ALERTS as of March 31, 2001

| 1203 Violation                          | Removals  | Resigned /<br>Retired / Died | Probation<br>Separation | Removed On<br>Other Grounds | Penalty<br>Mitigated | In Personnel<br>Process | Total      |
|---|-----------|------------------------------|-------------------------|-----------------------------|----------------------|-------------------------|------------|
| Seizure Without Approval                | 0         | 0                            | 0                       | 0                           | 0                    | 0                       | 0          |
| False Statement Under Oath              | 0         | 1                            | 0                       | 0                           | 0                    | 1                       | 2          |
| Constitutional & Civil Rights Issues    | 0         | 0                            | 0                       | 0                           | 0                    | 0                       | 0          |
| Falsifying or Destroying Records        | 1         | 4                            | 1                       | 0                           | 0                    | 2                       | 8          |
| Assault or Battery                      | 0         | 0                            | 0                       | 0                           | 0                    | 0                       | 0          |
| Retaliate or Harass                     | 0         | 4                            | 0                       | 0                           | 0                    | 3                       | 7          |
| Misuse of 6103                          | 0         | 0                            | 0                       | 0                           | 0                    | 0                       | 0          |
| Failure to File Federal Tax Return      | 37        | 80                           | 9                       | 5                           | 54                   | 28                      | 213        |
| Understatement of Federal Tax Liability | 0         | 2                            | 0                       | 0                           | 0                    | 1                       | 3          |
| Threat to Audit for Personal Gain       | 3         | 3                            | 2                       | 1                           | 1                    | 0                       | 10         |
| <b>Totals</b>                           | <b>41</b> | <b>94</b>                    | <b>12</b>               | <b>6</b>                    | <b>55</b>            | <b>35</b>               | <b>243</b> |

**Notes:**

1. The cases reported as "Removals" and "Penalty Mitigated" do not reflect the results of any third party appeal.

# Unsubstantiated §1203 Allegations with Other Proven Misconduct as of March 31, 2001

| 1203 Violation                          | 1203 Section | Removals | Resigned/<br>Retired | Probation<br>Separation | Suspension | Reprim'd  | Adminstr'n's | Counseling |           | Other     | Total      |
|---|--------------|----------|----------------------|-------------------------|------------|-----------|--------------|------------|-----------|-----------|------------|
|   |              |          |                      |                         |            |           |              | Written    | Oral      |           |            |
| Seizure Without Approval                | (b)(1)       | 0        | 0                    | 0                       | 0          | 0         | 0            | 0          | 2         | 0         | 2          |
| False Statement Under Oath              | (b)(2)       | 0        | 0                    | 0                       | 0          | 0         | 0            | 0          | 0         | 0         | 0          |
| Constitutional & Civil Rights Issues    | (b)(3)       | 0        | 0                    | 0                       | 0          | 1         | 0            | 4          | 2         | 0         | 7          |
| Falsifying or Destroying Records        | (b)(4)       | 1        | 0                    | 0                       | 4          | 1         | 1            | 2          | 1         | 3         | 13         |
| Assault or Battery                      | (b)(5)       | 0        | 0                    | 0                       | 0          | 1         | 0            | 1          | 1         | 1         | 4          |
| Retaliates or Harass                    | (b)(6)       | 2        | 3                    | 0                       | 5          | 11        | 6            | 26         | 17        | 10        | 80         |
| Misuse of 6103                          | (b)(7)       | 0        | 0                    | 0                       | 0          | 0         | 0            | 0          | 0         | 0         | 0          |
| Failure to File Federal Tax Return      | (b)(8)       | 5        | 45                   | 18                      | 9          | 21        | 21           | 40         | 11        | 19        | 189        |
| Understatement of Federal Tax Liability | (b)(9)       | 0        | 7                    | 0                       | 3          | 1         | 3            | 12         | 0         | 6         | 32         |
| Threat to Audit for Personal Gain       | (b)(10)      | 0        | 1                    | 0                       | 2          | 3         | 0            | 3          | 1         | 3         | 13         |
| <b>Totals</b>                           |              | <b>8</b> | <b>56</b>            | <b>18</b>               | <b>23</b>  | <b>39</b> | <b>31</b>    | <b>88</b>  | <b>35</b> | <b>42</b> | <b>340</b> |

## **7. TIGTA Reports**

### **7(a) TIGTA reports that both internal and external communication by the IRS needs improvement.**

#### **7(a)(1) What efforts are being undertaken to improve communications with taxpayers and the practitioner community?**

The operating divisions (OD) are looking at ways to improve communications with both employees and external stakeholders. Each OD has a communications director who will develop and implement communications strategies tailored to meet the needs of their specific stakeholders. For example, we have a new website for self-employed taxpayers. The agency is improving our website to provide more services and meet the needs of all the tax communities. We are planning many other improvements, such as making the language in our notices more understandable, and are already following the “plain language” guidance for government communications.

#### **7(a)(2) To what extent have resource limitations prevented the full implementation of customer service initiatives (e.g., the ability to access the toll-free number, and the availability of personnel able to assist Spanish-speaking taxpayers)?**

Resource limitations prevent us from assisting every taxpayer that calls or walks-in, or responding to written inquiries as quickly as we would like. We are, however, making progress in many of our customer service initiatives by moving to more self-assistance applications for taxpayers utilizing automated services by phone or through the Internet. Taxpayer attempts to our toll-free services were 26,126,051 through March 10, 2001. For the same time period in FY 2000 it was 34,152,749. We believe much of this demand reduction is due to better access to IRS systems, quicker response times, improved publications, web based self-assistance initiatives, and education efforts. In 2001 we are providing increased access to our automated refund assistance service by allowing taxpayers to select this option when they call our Toll-Free lines. We have increased the number of calls going to our TeleTax refund application by 57% over 2000. With the increased FTE received in FY 2001 for Toll-Free assistance during the filing season, we were able to move some tax topics back to live assistance from messaging assistance and reduce the need for Compliance resource assistance by about 55%. We also increased our Toll-free Spanish assistance by nearly 200 employees and have a dedicated site in Puerto Rico. Additional resources would permit us to move more quickly on our customer service initiatives by allowing us to provide more live assistance for complex issues while continuing to move less complex issues to self-assistance, as planned in our long-term vision.

For our Accounts Management staffs, resource limitations impair their ability to achieve desired levels of customer service. However, our capacity to expand in any one year is limited by other factors, including our ability to recruit and train large numbers of new employees, and space and equipment acquisition timeframes. With incremental increases in resources, we have, and can continue to make improvements in service.

**7(b) TIGTA notes that the IRS is still not in full compliance with:**

**7(b)(1) Restricting the use of enforcement statutes to evaluate IRS employees;**

**7(b)(2) Not designating taxpayers as illegal protestors;**

**7(b)(3) Providing timely notice that a federal tax lien has been filed;**

**7(b)(4) Properly withholding information in response to Freedom of Information Act or Privacy Act requests by taxpayers.**

**What is the IRS doing to correct this problem?**

**7(b)(1) Restricting the use of enforcement statutes to evaluate IRS employees.**

We have managed the implementation of the IRS Restructuring and Reform Act of 1998 Section 1204 requirements on the use of enforcement statistics by:

- Establishing business units to conduct quarterly certifications and perform an annual independent review of the program
- Centralizing responsibilities for general Section 1204 oversight, guidance, and training on the appropriate use of data and statistics in the Organizational Performance Division and having each business unit coordinate Section 1204 activity for their respective areas.
- Providing training for managers through a course on managing statistics in a balanced measurement system and for employees through a course on understanding the use of statistics
- Updating and revising the Internal Revenue Manual to provide guidelines for the new IRS business units and improve the independent review process.
- Working with TIGTA on its annual review and facilitating their audit of the program.

**7(b)(2) Not designating taxpayers as illegal protestors.**

We have taken the following steps to communicate and reinforce the requirements prohibiting IRS officers and employees from using the Illegal Tax Protestor (ITP) or any similar designation:

- Issued memorandum to IRS employees providing guidelines to discontinue the use of the ITP or any other similar designations, remove those existing designations from individual masterfile and other databases, and disregard any designation not located in the individual masterfile.
- Posted a question and answer paper, clarifying section 3707 issues and memorandums on section 3707, to the National Resource Center website.
- Submitted a Request for Information Services (RIS) (EXM-8-0106) to eliminate the transaction code (TC) 148-02 from the masterfile. The TC148-02 was an indicator identifying ITPs.

Eliminated references to the ITP designation in the Internal Revenue Manuals and other internal documents.

### **7(b)(3) Providing timely notice that a federal tax lien has been filed.**

TIGTA has completed two mandatory lien audits:

- “The IRS Should Improve It’s Federal Tax Lien Procedures,” issued September 1999
- “Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Yet Been Achieved,” issued September 2000.

The TIGTA is conducting the FY 2001 mandatory lien audit.

As the result of the two completed audits, TIGTA made five recommendations (2 – 9/99 and 3 – 9/00) to improve the lien process. We initiated a total of fourteen corrective actions to address the recommendations and of this date have completed eleven. The three remaining corrective actions are scheduled for completion on or before June 1, 2001.

The following corrective actions have been completed:

September 1999 Audit

- 1) We programmed the Automate Lien System (ALS) to reissue notices and recalculate the time period for requesting a hearing. However this process will require manual input of undelivered mail and new address information where available. ALS will then recalculate the taxpayer’s time period for requesting a hearing.
- 2) We issued memorandum to appropriate field and customer service employees to ensure that either the “&” or “and” is used in spousal situations. We will add a new procedure requiring employees to provide multiple address information, if appropriate. We will also include a reminder that partnership

information is not available to ALS and should be sent to the ALS Unit for manual input and automated preparation of RRA 98 lien notices.

- 3) We have procedures to address the issuance of the RRA 98 lien notices to taxpayers' representatives. However, a future enhancement to the ALS will allow users to generate a taxpayer representative contact letter and will associate a copy of the original RRA 98 lien notice and attachments sent to the taxpayer after the manual input of certain information.
- 4) Customer Service issued Taxpayer Service Electronic Bulletin Board (TEBB) #99280, dated August 23, 1999, titled Post Lien Filing Notice. It added instructions to the Internal Revenue Manual (IRM) 21.9.4, Enforcement Actions, and IRM 21.9.8, Automated Call System (ACS) Support, to implement the actions agreed to by Collection. The TEBB instructions have also been added to the IRM 21 revision being issued January 1, 2000.
- 5) We enhanced the ALS system to retain manually input information related to the return of RRA 98 lien notices for ACS employees.
- 6) We added procedures to the Lien Handbook requiring employees to forward the Form 12153 and envelopes to Appeals for hearings requested after the 30-day period has elapsed. Issue interim procedures by November 30, 1999.
- 7) We added IRM procedures to the Lien Handbook to clarify that Form 668(Y)(c) be printed and mailed, at a minimum, weekly. Issue interim procedures by November 30, 1999.
- 8) We added provisions to the IRM for field employees to research case files for new address information when RRA 98 lien notices are returned undelivered. Issue interim procedures by November 30, 1999.
- 9) We conducted program reviews to measure compliance of RRA Notice of Federal Tax Liens (NFTL) notification requirements.

#### September 2000 Audit

- 1) We revised the current quarterly compliance review checksheet to incorporate Power of Attorney (POA) notification, case file review for new address, and re-issuance of collection due process notice.
- 2) We prepared a memo informing the field of the new requirement for group managers to review documentation to ensure that the taxpayer's representative receives a copy of the Collection Due Process Notice.

The following corrective actions have not been completed:

September 2000 Audit we will:

- 1) Revise the IRM to require group managers to include POA notification in their case review. Proposed Completion Date: 4/01/01
- 2) Return cases with legal and or procedural violations to appropriate district for corrective actions. Proposed Completion Date: 4/01/01

- 3) Receive verification from district management that the corrective actions, for cases in corrective action 2, are complete. Proposed Completion Date:6/01/01

**7(b)(4) Properly withholding information in response to Freedom of Information Act or Privacy Act requests by taxpayers.**

We have conducted three annual reviews of the IRS FOIA/Privacy closed case files since the enactment of the RRA98 statute. Each year we have incorporated the TIGTA findings into corrective action plans. We have completed most of the corrective actions, but a few are either ongoing initiatives or are nearing completion, with September 2001 as the anticipated completion date.

The TIGTA reported no significant findings or widespread evidence that the IRS incorrectly applied the confidentiality statutes (the issue that the statute charged TIGTA to review). In addition, the error percentages given in the report are attributable only to the denied documents (including partial denials and instances of no record of responsive documents). The denied, partially denied and no-documents-responsive replies to FOIA and Privacy Act requests constitute only a fraction of the total volume of requests processed each year. The universe of FOIA requests lies between 25 and 30 thousand. The universe of denials sampled is approximately 6,000. From a sample of approximately 150 requests resulting in an IRC 6103 or FOIA(b)(7) denial, this years TIGTA review considered 16. Of that 16, a significant portion was due to misinterpretation of computer transcripts resulting in constructive denial of data rather than intentional withholding of data.

Though the IRS is short of “full compliance,” our compliance ratio is greater than 90%. In fact, preliminary discussions of the current review indicate the TIGTA may have no further recommendations for improvement other than those already in progress. Recommended actions include efforts to increasing training in computer transcript reading skills and continuing training in the application of the various FOIA exemptions (including (b)(7)).

**7(c) TIGTA recently reported that the IRS processing procedures were not designed to identify and correct a credit when outdated estate tax returns were used by taxpayers. As a result, an estimated 1,250 estates of decedents may have overpaid \$11.6 million. More generally, TIGTA reported that the IRS had payments totaling \$2.3 billion in its Excess Collections Accounts and that taxpayers do not always receive credit for certain tax payments due to computing system limitations and processing procedures. What is the IRS doing to correct these problems?**

Our Submission Processing “pipeline” operations changed procedures to systemically identify outdated estate tax returns, earmark them for additional review, and match the proper credit to the appropriate tax year. The IRS notifies

taxpayers of the credit adjustments through its math error notice processing.  
(Completed in May 2000)

To ensure we apply credits in Excess Collections to taxpayer's accounts, we:

- Used a TIGTA program to generate two "clean-up" listings allowing credits to be matched and moved from Excess Collections back to the appropriate taxpayer's account. (Completed December 2000)
- Are making programming changes to periodically generate a listing of all "OPEN" credits in Excess Collections. We will review this listing and apply payments appropriately to the taxpayer's account. (Implementation July 2001)
- Implemented procedures to keep credits on Masterfile for accounts that require a return to be filed. The account will remain open and available on Masterfile during the statutory period so the IRS may actively pursue the taxpayers return and case resolution. (Implemented April 2000) During this time, we will send the taxpayer a notice every 6 months as a reminder that we have credit(s) available and the taxpayer must file to receive the credit.(Implementation April 2001)

## 8. Fiscal Year 2000 Financial Statements

The GAO's financial audit for fiscal year 2000 identified six material weaknesses in the IRS's internal controls. These weaknesses related to the IRS's control over: (1) the financial reporting process; 2) management of unpaid assessments; (3) refunds; (4) property and equipment; (5) budgetary activities; and (6) computer security. According to the GAO, these weaknesses have allowed inappropriate refunds to be paid, reduced the effectiveness of the IRS in enforcing the tax code, resulted in error in taxpayer accounts, and increased taxpayer burden. GAO, Financial Audit: IRS Fiscal Year 2000 Financial Statements (GAO-01-394, March 2001) at 84. These weaknesses also were identified in GAO's financial audit for fiscal year 1999. GAO, Financial Audit: IRS Fiscal Year 1999 Financial Statements (GAO/AIMD-00-76, February 29, 2000).

### 8(a) Has any progress been made in strengthening the IRS's control over these areas?

We made significant progress in strengthening controls in these areas and in improving our accounting practices. While we are pleased with our progress, we recognize that, to retain a clean opinion and improve management of our operations, we must maintain the same momentum for our future audits, continue to address identified problems, and focus on our modernization efforts.

Financial Reporting Process -- "...IRS did not have adequate internal controls over its financial reporting process. IRS was unable to routinely, reliably, and timely generate the information needed to prepare its financial statements and manage operations on an ongoing basis.”:

- We revised our reporting and disclosure for the statement of net cost to properly classify IRS programs.
- We developed a set of policies and procedures for preparing our custodial financial statements.
- We continue to make progress towards replacement of our core administrative financial system and on the Custodial Accounting Project (CAP).
- The new Integrated Financial System (IFS) will provide timely and reliable financial, cost, and property accounting data, fulfilling the needs of the IRS for management information. As part of the modernization effort at the IRS, the IFS project is following a disciplined enterprise life cycle approach and is currently in the approval stages with a projected implementation date of October 1, 2003. The Custodial Accounting Project will provide a single data repository of taxpayer accounts and information for financial reporting. This project has received approval from the Core Business System Executive Steering Committee (CBS ESC) to continue Milestone 4 development activities, with a projected completion date of July 2003. We included the

project on the list of approved projects that receive Information Technology Investment Account funding, and the CAP functionality is included in the IRS Modernization Blueprint 2000. Additionally, through other modernization efforts, we replace existing legacy systems. We need these systems and related process improvements to fully address the root cause of this material weakness.

Management of Unpaid Assessments – “...the lack of an effective subsidiary ledger; errors and delays in recording taxpayer information, payments, and other activities; and the inability to actively pursue significant amounts in outstanding taxes owed to the federal government continue to hinder IRS’ ability to effectively manage unpaid assessments.”

- We improved our ability to substantiate unpaid assessments.
- We established a task group to review and recommend necessary changes to address the issues related to Trust Fund Recovery Penalty (TFRP) processing (e.g., delays in posting, related tax liabilities, etc.). This group developed programming requirements to design an automated TFRP system (that allows for systemic links). We have completed Phase I initial programming. By the end of FY 2002, we will complete the implementation of Phase II which will systematically accept downloads of data and cross-reference payments received for assessments made.
- We will include a Taxpayer Account Subledger to provide the ability to identify duplicate trust fund recovery assessments, taxes receivable, compliance assessments, and write-offs for financial reporting purposes in the CAP.
- We addressed the process of matching information return data to tax returns at a high level in multiple model views throughout version 1.0 of the Enterprise Architecture (or the Modernization Blueprint). The Tax Administration vision specifically calls for electronic receipt of information returns (e.g., W-2, 1099), which will accelerate the tax return matching process and prevent erroneous refunds.

Refunds – “...weaknesses in IRS’ controls over refund disbursements and other management challenges expose the federal government to material losses due to disbursing improper refunds.”

- We have succeeded in several of our efforts to prevent erroneous Earned Income Tax Credit (EITC) refunds from being issued. Specifically, we:
  - (1) Used the IRS’ dependent database to identify questionable issues relating to EITC
  - (2) Implemented the new legislation requiring re-certification before the taxpayer can claim EITC on the current tax year due to improperly claiming EITC in the previous year (Since 1999, we have worked over 55,000 re-certification cases.)

- (3) Banned taxpayers from claiming EITC for either two or ten years after the tax year where we decided the taxpayer's claim was due to intentional disregard of the rules and regulation or fraud (This has resulted in 7,680 two-year bans and 62 ten-year bans for processing year 2000, and 337 two-year bans and two ten-year bans for processing year 2001, mid-February.)
- (4) Implemented an automatic freeze on refunds where there is an open examination

- We expect to implement a programming change to better identify returns that may have discrepancies in 2001.
- We issued procedures requiring employees and their managers to document their monitoring of manual refunds to ensure we do not issue duplicate refunds, starting October 1, 2000.

Property and Equipment (P&E) – "...serious weaknesses in its P&E systems and controls continue to prevent it from having P&E information available on an ongoing basis for management purposes and from having reasonable assurance that its assets are properly safeguarded and used only in accordance with management policy."

Prior to October 1999, we had multiple information systems organizations in IRS outside the Chief Information Officer (CIO) organization. This was a major contributing factor to the lack of accountability and commitment in maintaining an accurate and complete Information Technology (IT) inventory, thus the longstanding property material weakness. Today, the IRS has one information systems organization with total responsibility for the IT inventory. Since October 1999, the Information Systems organization has made significant progress in improving how the inventory is managed and maintained.

To implement the GAO recommendation that "systems and controls be in place for FY 2000," we devoted our P&E employee resources to undertake and accomplish that task. The IRS had already established the Financial and Management Controls Executive Steering Committee (FMC ESC). The FMC ESC is chaired by the Deputy Commissioner and is the major coordination point in IRS for improving financial management systems. The FMC ESC established the Property Subcommittee consisting of executive participation by the offices of the CIO, Chief Financial Officer (CFO), and Procurement. This Subcommittee met weekly and made decisions to ensure we developed and monitored systems and controls for P&E. This Subcommittee will continue until we have resolved all property issues.

Pending the implementation of an integrated property management system, the Property Subcommittee developed an interface between the IRS' requisition tracking system (RTS), its automated financial system (AFS), and its property tracking system, the Integrated Network and Operations Management System

(INOMS). By establishing a common identifier, the procurement award number (PAN), it allowed all systems involved in IT acquisition to account for the order, the receipt, the payment, the location, and the disposition of items in the inventory system, throughout the entire lifecycle of the asset's acquisition, ownership and disposition by IRS. IRS employees performed extensive manual research to back-fill the linking information into the INOMS database prior to inputting the common identifier on a daily basis. The automated integrated capability is scheduled for implementation as outlined in the IRS Strategic Plan.

Also during FY 2000, we issued a policy to capture the costs of internally developed software. We will use this policy as guidance in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) Number 10, titled, *Accounting for Internal Use Software*, with an effective date of October 1, 2000.

We implemented the new Single Point Inventory Function (SPIF) in each of the major offices with trained, dedicated, full time resources for IT property inventory activities--a first for the IRS. This includes policy and procedures that establish clear accountability in the receipt, distribution, and disposal of ADP hardware, software and telecommunications property at all designated sites. The issuance of Policy P-1-229, "Management and Control of ADP Property," designates the CIO as the official responsible for the ownership, management, and control of all IT assets in the IRS. This in itself is a major improvement in controlling who can acquire, relocate, and dispose of IT property. It also identifies the roles and responsibilities of designated personnel to support the SPIF Automated Data Processing (ADP) property management function.

We established the Asset Management Modernization Project Office whose full time job is to implement industry "best practices" and deploy new automation tools (e.g., Peregrine 35 upgrade, auto discovery capability, and new scanner technology).

The Information Systems personnel completed a 100 percent book-to-floor and floor-to-book inventory of all the computer hardware and software at all offices throughout the IRS. Additionally, we reengineered our physical inventory process to adopt industry "best practices," allowing the physical inventory process to continue throughout the fiscal year using auto discovery tools to reduce the annual physical inventory costs. Other improvements currently being implemented involve an improved disposal process that ensures we update inventory records promptly.

For near-term and long-term improvements, we have plans to implement two additional improvement phases that enhance processes related to automation capabilities. This will include the integration of non-IT assets with IT assets creating a single repository for all IRS property and equipment. In addition, We

also plan to integrate the three related subsystems (procurement, asset, and financial tracking systems) as outlined in the IRS Strategic Plan.

Budgetary Activities – "...IRS' internal controls continued to be inadequate in providing reasonable assurance that its budgetary resources were routinely accounted for, reported, and controlled.... Undelivered orders were not always reduced...or were understated due to inappropriate deobligating of funds.... errors in IRS' accrued expenses recorded at the end of fiscal year 1999, which resulted in misstating the beginning balance of undelivered orders for fiscal year 2000. ...IRS recorded incorrect activity as adjustments to obligations."

During FY2000, we

- Reduced the number of employees with authority to override automated spending controls
- Reduced the dollar amount and duration of transactions held in suspense
- Issued policy memoranda and implemented procedures to deobligate funds no longer required for a specific purpose
- Worked closely with the Procurement Division to identify and de-obligate funds that were no longer required
- Developed a subsidiary ledger of undelivered order and all related activities that allowed for easier review and audit of obligations
- Worked with Procurement, FPM's and COTR's of several major projects, that had recently been completed, to ensure the appropriate accruals were established and unneeded funds were de-obligated
- Instituted new policy requiring the BFC to verify the accuracy of the ship date/delivery date on the invoice and the receipt date in the accounting system
- Developed systemic process of posting accrual information from payments made after September 30<sup>th</sup>.
- Developed system of matching subsequent payments to accruals as recommended by GAO
- Revised interface between IPS/RTS and AFS so that appropriate receipt information is processed in AFS
- Worked with GAO to eliminate offsetting upward and downward adjustment transactions that were identified as incorrect adjustments to obligations.

In FY 2001, we

- Continue to work with the Procurement Division and all functional areas to identify and de-obligate funds that are no longer required
- Are enhancing the undelivered order subsidiary ledger developed in FY 2000 by providing additional information, an improved format, easier access, etc.
- Are working with the Procurement Division to get period of performance information in IPS/RTS to interface with AFS -- This will allow the IRS to focus on de-obligating funds on obligations that have expired performance dates
- Are exploring positive incentives to entice functional unit to de-obligate funds

- Are working with the Procurement Division to allow “acceptance date” in IPS/RTS to interface with AFS -- This will allow end users to input receipt date information into AFS and not generate a payment
- Are working with GAO on an alternative approach to the fiscal year end accrual process that will allow accruals to be based on estimates and not necessarily subsequent disbursements
- Are working with the Procurement Division to allow non-commercial procurements to be processed through IPS/RTS -- This will allow receipt information to be interfaced through IPS/RTS to AFS and improve the accrual process
- Are identifying offsetting upward and downward adjustments periodically, during the fiscal year, as prescribed by GAO.

Computer Security – “Much remains to be done to resolve the significant control weaknesses that continue to exist within the IRS computing environment.”

Recognizing the critical need to enforce federal law and regulations concerning privacy and non-disclosure of confidential tax information, we created the Office of Security (OS) to establish and enforce standards and policies for all major security programs including, but not limited to, physical security, data security, and systems security. The OS gives us a proactive, independent security group directly responsible for the adequacy and consistency of security and privacy over all our operations.

The OS’ approach is consistent with GAO’s September 1996 report, *Information Security: Opportunities for Improved OMB Oversight of Agency Practices*, which noted that, “Such a program can provide senior officials a means of managing information security risks and the related costs rather than just reacting to individual incidents.” OS is reviewing each type of facility so we can set priorities for resources and to measure and demonstrate success in improving the overall security posture of the IRS. OS is taking a proactive approach by conducting security reviews at the computing centers and campuses at least twice a year. OS is also working with local and Headquarters management to develop solutions, monitor implementation, and conduct on-going reviews to ensure weaknesses do not reoccur. This focus on critical assets has been further supplemented by the Presidential Decision Directive (PDD) 63, Critical Infrastructure Protection.

Since 1997, the Office of Security, within the IRS, has been actively involved in identifying and correcting security weaknesses throughout the IRS. These weaknesses have been identified by the General Accounting Office, the Treasury Inspector General for Tax Administration (TIGTA) and also by the Office of Security. The Office of Security conducts comprehensive security reviews of IRS facilities that identify both local and systemic weaknesses. Their recommendations require either local action or broader steps such as policy guidance, revised operating procedures, training or new technological

approaches. During the four years since 1997, we have made major improvements in physical, data and systems security assurance, although a number of weaknesses remain. The General Accounting Office made note of our progress in this area in their most recent High Risk Update (January 2001). They said "IRS has made notable progress in improving computer security at its facilities, corrected a significant number of identified weaknesses, and established a Service-wide computer security management program that should, when fully implemented, help the agency effectively manage its security risks". Some of our significant achievements include:

- *Improvement of the security status of existing systems.* We have developed and implemented security standards and procedures for the installed base of systems, including standards for IBM mainframe systems, Unisys systems, UNIX, and Windows NT systems. We conduct vulnerability assessments using these standards as a baseline.
- *Development of security architecture for the IRS modernized systems environment.* Working with the PRIME Alliance, we have established an Enterprise Architecture, which has integrated security features throughout the architecture.
- *Improvements to the established systems certification and accreditation process.* We have made progress in improving our paper-based systems certification and accreditation process. First we built it into the systems life cycle used for developing new systems. Second, we automated the process to make use of automated tools and government best practices.
- *Continuing emphasis on the Unauthorized Access (UNAX) program.* In 1997, we established our UNAX program which, focuses on manager responsibility and communication to employees, to establish and maintain a culture of personal responsibility and accountability to protect the confidentiality of taxpayer records. We have:
  - Expanded the ability to detect unauthorized access through tracking tools
  - Communicated extensively about UNAX prohibitions
  - Issued written guidance to managers and employees
  - Administered stringent penalties, and
  - Tracked disciplinary outcomes to determine effectiveness
- *Creation of an enterprise Computer Systems Incident Response Center (CSIRC).* We improved our incident response capability by establishing of the CSIRC, which is focused on managing incident detection and response agency-wide. A cooperative effort between Information Systems Operations, TIGTA and the Office of Security, we created the CSIRC to provide real time monitoring, and allow us to respond to security incidents quickly and precisely, and to provide the documentation necessary to prosecute intruders.

- *Facilities upgrades to improve security.* Over the last 4 years we have dramatically improved physical security at key facilities. Work continues in this area.
- *Development of assessment tools and techniques that allow us to identify and prioritize areas of vulnerability in an objective, measurable manner.* We have adopted, modified, and implemented the draft IT Security Assessment Framework developed for the Federal CIO Counsel by the National Institute of Standards and Technology. This Framework gives us a structured tool to use in assessing the security posture of the enterprise, and tying that assessment to strategic and tactical plans that will facilitate prioritization of resources.

We are addressing security and privacy in its Business Systems Modernization effort. In the future, this will give taxpayers the ability to access Internet based refund status information. We are developing the Security Technology Infrastructure Release (STIR), to give us a standard platform for Web-based applications. The STIR design follows a rule-based architecture, which governs access to and control of information based on users, by controlling different data permissions for IRS employees, organizations with which IRS has a trusted relationship and the public at large.

As with any organization, the resources available for security enhancements and upgrades are limited and must be prioritized. Many of the corrective actions we are taking are multi-year efforts. In 2001, we are further enhancing our cyber-security capabilities to better deal with increasing threats from hackers, viruses and other breaches. Because the solutions are complex and involve specialized skills, we are working with other federal agencies to identify best practices. As we are increasingly relying on centralized systems, we have also focused our security efforts on identifying the physical security and disaster recovery capabilities needed to mitigate the risks associated with terrorist threats. Although we have been able to reallocate resources to address most risks, others remain that will require substantial longer-term investments, which are currently unfunded.

We understand that although new technologies will help to streamline the agency's operations and improve the delivery of services to taxpayers, these same technologies must be controlled to ensure adequate security. This continues to take on greater significance as IRS' reliance on paper decreases and its dependence on new technologies increases. To support this new service delivery, we plan to move toward a more comprehensive Mission Assurance approach, creating a seamless relationship between security and the business processes of the organization. This will involve business executives more intimately in risk management of the assets and business processes they manage.

In summary, we have taken many significant steps during the past four years toward implement a robust, reliable and responsive security program to protect taxpayer data from external and internal intrusion. These steps focus on all aspects of security – information, personnel, physical – and incorporating both advanced preventive measures and remedial mitigating measures for weaknesses that are already documented. We believe our program will become even stronger during the next several years as we strengthen the bond between security and the business processes and build security into the structures that are the foundation of a modernized IRS.

### **8(b) How have the IRS's accounting practices improved?**

#### IRS Accounting Practices:

We implemented reconciliation procedures for IRS fund balances and ensured prompt review/reconciliation was performed. Other improvements to IRS accounting processes are discussed above in relation to improving controls on material weaknesses, specifically we:

- Revised our reporting and disclosure for the statement of net cost
- Developed policies/procedures for preparing custodial financial statements
- Improved our ability to substantiate unpaid assessments
- Took steps to prevent erroneous EITC refunds
- Developed an interface between our requisition tracking, financial, and property tracking systems
- Issued policy to capture costs of internally developed software
- Completed 100 percent book-to-floor and floor-to-book inventory of all hardware and software and reengineered the physical inventory process to allow it to continue throughout the fiscal year
- Reduced the number of employees with authority to override automated spending controls
- Reduced the dollar amount and duration of transactions held in suspense
- Implemented procedures to deobligate funds no longer required for a specific purpose

## 9. Revenue Protection

**9(a) In filing season 2000, the IRS planned to test the Dependent Database to ensure the validity of identifying numbers in its efforts to prevent overclaims of the earned income tax credit. The Dependent Database includes records from the Social Security Administration and the Office of Child Support Enforcement at Health and Human Services, which links the names and social security numbers of dependent children with the names and social security numbers of their parents.**

**9(a)(1) Has the IRS tested the Dependent Database? What were the results of the test? How accurate is it? What errors in the database have been detected?**

The Dependent Database (DDB) identifies potentially non-compliant returns during returns processing. It pulls data from both internal and external data sets, including those provided by the Department of Health and Human Services (HHS) and the Social Security Administration (SSA).

We completed testing of the DDB in FY 2000 and implemented the system nationwide in January 2001. Upon receipt of the HHS data in February 2000, we selected about 10,000 returns for examination between March 15 and May 2, 2000, and classified them for potential errors. We held potential refunds on these returns and forwarded the cases to Examination. The return selection criteria, developed with HHS and SSA data, were most successful when combined with other IRS data on filing characteristics and duplicate claims of children for dependency exemptions and the EITC. For example, when a child's SSN was used multiple times, the data helped determine which taxpayer was most likely to be noncompliant in claiming tax benefits for that child.

Because many of the selected returns are still in the examination process, we have not yet completed our final analysis. However, we have identified some limitations in the usefulness of the data:

- The new SSA data, linking parents' SSNs to those of their children, remains limited because of the short time SSA has been gathering the data.
- The HHS data records do not contain the date when the records were created in the system. Thus, the IRS is unable to determine whether documents provided by taxpayers are more current than HHS' records.
- The data contains inconsistencies because the HHS database is reliant on data provided by the individual states. These inconsistencies include multiple records for the same child and missing data elements, such as the SSN for the child or the custodial party.

- Not all of the states are providing all of their records. In December 2000, HHS indicated four states had no records for children and two had partial records.

**9(a)(2) Has the use of the Dependent Database had any effect on revenue protection?**

In Fiscal Year 2000, we limited our work on the DDB application, including the use of the HHS and SSA data, to testing. This year we are using the DDB application nationwide, with enhanced selection criteria, as part of the Examination Program and for the identification of noncompliant taxpayers and paid preparers. We will design future education and outreach efforts based on findings from the analysis of the DDB data. Because we will conduct examinations before the release of tax refunds, we expect revenue protection in FY 2001. We expect education and outreach efforts to result in revenue protection measurable by the reduction in error rates in returns filed during the 2002 filing season.

**9(b) What efforts are being made to stop the promotion of illegal tax avoidance schemes (e.g., taxpayers claiming that the income tax does not apply to individuals, etc.)?**

Criminal Investigation's (CI) new organizational structure will promote more efficient and effective operations. Headquartered in Washington, DC, reporting directly to the Commissioner of Internal Revenue, CI is ideally placed to formulate policy, direct, guide, and support field operations and promote better cooperation within the IRS. We realigned CI's field offices to better conform to the boundaries of the federal judicial districts. This realignment will enhance cooperation and coordination with the United States Attorney's offices and facilitate the accomplishment of the IRS mission to apply the tax law with integrity and fairness to all.

The CI Compliance Strategy, established in 1999, will continue to guide operations. This strategy is comprised of three interdependent and mutually supporting programs, Legal Source Tax Crimes, Illegal Source Financial Crimes, and Narcotics Related Financial Crimes. This balanced approach to case development and investigation has enabled CI to effectively use all statutes within its jurisdiction, the grand jury process, and a broad range of all enforcement techniques to combat tax, money laundering, and currency crimes. It also provides the flexibility needed to quickly respond to changes in local compliance priorities, issues, and financial crime trends.

***Publicity Strategy***

Criminal Investigation has established a public information officer position in each of the 35 field offices. The special agents assigned to these positions serve as points of contact for all internal and external CI communications initiatives,

including press releases and the coordination of important law enforcement media events. News coverage of successful prosecutions helps foster compliance and public confidence in the tax system.

In order to educate and warn the public about illegal tax schemes, Criminal Investigation maintains an Internet website at [www.treas.gov/irs/ci](http://www.treas.gov/irs/ci), and the Small Business Self-Employed Operating Division maintains a website at [www.irs.gov/smallbiz](http://www.irs.gov/smallbiz). These websites identify tax fraud alerts and contain detailed information, press releases, and case summaries related to various schemes: "Abusive Trust Scheme"; "Employment Tax Fraud"; "Why Do I have to Pay Taxes?"; "Social Security Refund Hoax"; and "Slavery Reparations Tax Refund Scam."

Criminal Investigation will continue to update the material on its website, and add new sections covering other program areas as appropriate.

Below is a summary of our enforcement efforts associated with some of the more common illegal tax schemes.

### ***Foreign and Domestic Trusts***

According to USA Today, more than \$4.8 trillion in wealth will be inherited or transferred from one generation to the next by 2015, with much of it transferred through a variety of trusts. Filings of trust returns are now the third most frequently filed income tax return after individual and corporate returns. Although the vast majority of these transfers are legal, the potential for fraud is widespread.

In fiscal year 1999, Criminal Investigation elevated abusive foreign and domestic trusts from an emerging issue to a program area. We elevated this issue because of the proliferation of abuse promotions in the U.S. Criminal Investigation is aggressively combating trust schemes by conducting investigations of abusive promoters and their clients, where appropriate. We address fraudulent trust issues through a national strategy that includes Criminal Investigation, Small Business/Self Employed (SBSE), Large & Midsize Business (LMSB), Chief Counsel, and the Department of Justice. As part of this strategy, we place emphasis on cross-functional coordination, the identification of fraudulent trust promotions, and the use of civil and criminal enforcement actions.

Criminal Investigation and civil components have engaged in outreach activities, such as presentations to professional organizations, the creation and distribution of an information pamphlet, IRS Public Announcement Notices, warnings posted on the Internet and extensive media coverage to help people recognize and avoid fraudulent trust promotions.

### ***Nonfiler Program***

The nonfiler population has increased throughout the decade. To address this concern, the Internal Revenue Service has implemented a cross-functional National Nonfiler Strategy. The overall goal of this strategy is to bring taxpayers back into compliance.

Criminal Investigation's role in this program is the enforcement of the tax laws for individuals who are not responsive to outreach efforts. Criminal Investigation has devoted resources to identify these individuals and in the most flagrant cases, criminal prosecution has and will continue to be recommended. Historically, CI has been involved in projects aimed at identifying and prosecuting the most flagrant nonfilers in a variety of occupations and industries, including wage earners, accountants, lawyers, doctors, public officials, the self-employed, corporate officers and narcotics traffickers. Criminal Investigation has also been involved in prosecuting those nonfilers who belong to groups that support militant anti-government and anti-taxation philosophies.

Criminal Investigation has increased its participation in the FBI's Joint Terrorism Task Forces being organized in major cities. The unique investigative skills of CI special agents have proven effective in investigations of extremist elements that support anti-taxation, anti-government philosophies. Many of these individuals fail to file tax returns or file frivolous returns. Criminal Investigation will develop and conduct high impact investigations of nonfilers in various occupations and industries, as well as those nonfilers who file non-processable returns or seek to undermine the tax system by employing frivolous arguments the courts have repeatedly rejected. Criminal Investigation's ability to investigate and prosecute flagrant cases and to generate publicity is a valuable compliance tool.

### ***Employment Tax Fraud***

"Pyramiding" and "employee leasing" are perhaps the two greatest areas of concern for Criminal Investigation involving employment tax fraud. "Pyramiding" is the fraudulent practice of companies withholding employment taxes from employees but failing to remit payment to the IRS. Businesses involved in "pyramiding" frequently file for bankruptcy to avoid payment for these liabilities, then start a new business under a different name. "Employee leasing" is the practice of contracting with outside businesses to handle all administrative, personnel, and payroll concerns for employees. In some instances, employee leasing companies fail to pay to the IRS any portion of the collected employment taxes.

We believe the continued use of appropriate criminal enforcement actions and the publicity generated by those actions will help deter those who are involved in this illegal activity. Criminal Investigation is exploring the need to form dedicated teams of criminal investigators and civil component employees to investigate and prosecute responsible parties.

### ***Questionable Refund Program***

The Questionable Refund Program (QRP), administered by CI, is a nationwide multifunctional program established in January of 1977. The QRP identifies fraudulent returns, stops the payment of fraudulent refunds, and refers identified fraudulent refund schemes to CI field offices. While the primary focus is on individual tax returns, we also review business tax returns under the QRP.

Questionable Refund Detection Teams (QRDT) are located in the CI Fraud Detection Centers (FDCs) on the ten campuses. The QRDT reviews questionable tax returns identified by manual or computerized screening techniques. We refer schemes with criminal potential to CI field offices for investigation. In addition, many returns are referred to other appropriate Operating Divisions as well as to the Adjustments Section for appropriate civil action.

Communications from Electronic Return Originators (ERO), financial Institutions, return preparers, and concerned citizens also identify QRP schemes.

The Electronic Fraud Detection System (EFDS) is a computer system located in the FDCs on the ten campuses and many CI field offices. The EFDS automates the computer identification output for potentially fraudulent Electronic Filed (ELF) tax returns, increases data available for analysis, and assists in the development of information relating to paper and ELF schemes detected by the QRDTs. The EFDS not only provides a means to review potentially fraudulent ELF tax returns "on-line" but also allows queries of various databases to identify other returns with similar characteristics.

The QRP area also attracts a relatively new type of crime, that of identity theft. On October 30, 1998, The Identity Theft and Assumption Deterrence Act of 1998 went into effect. Criminal Investigation is now able to investigate and recommend prosecution under this statute in tandem with the investigation of substantive tax and money laundering violations from refund fraud and money laundering schemes.

### **9(c) What progress has been made in developing a business results measure for voluntary compliance to assist in targeting areas of noncompliance?**

Balanced measures are being developed at the strategic and operational management levels along with associated reporting mechanisms. Measures will be used in assessing IRS' overall performance in meeting its missions and strategic goals, and include such aspects as voluntary compliance, customer satisfaction, burden, and productivity.

We have developed the conceptual framework for a series of strategic measures focused on three core components that make up overall compliance: filing compliance, reporting compliance, and payment compliance. Each of the three

core components has a key corresponding rate measure (i.e., the voluntary filing rate, the voluntary reporting rate, and the voluntary payment rate). The proposed measures also include some absolute amount figures so as to provide insights into their relative share of the tax gap. Finally, the conceptual framework calls for additional breakouts by type of tax and by IRS business operating division, within each of the three core components, to help further target areas of noncompliance. Work is focused on ways to secure data for the major portions of this conceptual measures framework for voluntary compliance. Development of Service-wide strategic measures is on track for September 2001 release, with corresponding data reporting for many of these measures on track for September 2002.

**9(d) What benefits have resulted from diverting compliance resources to customer service?**

We have been able to provide an increased level of service to our customers in both our walk-in sites and our toll-free services. In our toll-free operation, as mentioned in an earlier question, we have reduced our compliance requirement 55% over our 2000 need; however, compliance personnel continue to assist in customer service during the filing period beginning in early January through our April peak. They have already answered 328,000 plus inquiries through March 10, 2001 on our most complex tax law questions. Diverting compliance personnel provides needed quality expertise to our toll-free work force. We have plans to continue to train our own customer service employees and specialize our work in toll-free to meet customer demand by the beginning of January 2003. The Service also developed operational balanced measures for all major units within the operating/functional divisions. Deployment of measures to the territory or equivalent level will be completed at the beginning of FY2002. Development of Servicewide strategic measures is on track for 9/2001, with appropriate data reporting on track for 9/2002.

## 10. Collection

**10(a) The IRS has noted that the due process provisions of the IRS Reform Act, which increase taxpayers' rights during the collection process, have increased the IRS's workload far more than anticipated.**

**10(a)(1) Have staffing needs to implement these provisions been met?**

Staffing needs have increased as a result of the additional due process requirements imposed by RRA 98. The IRS has been analyzing the impact of these provisions on workload to determine appropriate staffing.

At the front end of the collection process, due process provisions have raised the need for resources at our Automated Collection System sites. Before the implementation of the Act, many of our levy actions were systemic and required minimal staff intervention. Now, we must have individually reviewed the facts and circumstances of each case before initiating a lien or levy action. In addition, once the hearing request is received, ACS is required to take actions to prepare the case for referral to Appeals. ACS staff that had formerly been applied to working collection cases have been redirected to handle the processing of Collection Due Process (CDP) requests.

To ensure that we maximize our staffing resources, we are examining our internal operations and workflow to identify opportunities to streamline and improve our handling of these accounts. The IRS convened an executive level task force to review the due process program. An implementation team is in place to implement process improvement recommendations identified by the task force to include:

- Establishing a due process program review in Appeals.
- Developing a Best Practices and Case Management Guide for managers.
- Creating a standardized Appeals referral form to clearly identify the issues being raised by the taxpayer and to assist Appeals in analyzing workload.
- Establishing special purpose job aids and an internal CDP web-site to provide quick reference materials.
- Developing of Abbreviated Appeals Case Memos to streamline the hearing process in situations where the taxpayer and the Service have reached agreement.
- Establishing a procedure that provides time for the collecting office to work with the taxpayer after a hearing request has been made.
- Establishing an inventory tracking system to assist in assessing and predicting due process workload.
- Reviewing lien filing and systemically proposed levy notice criteria.

- Developing a test where employees familiar with automated collection system (ACS) processing are assigned to Appeals to assist in due process hearing requests.

When the due process provisions went into effect in January 1999, Appeals had approximately 60 settlement officers trained to work collection issues. Currently, 229 Appeals personnel, including 67 settlement officers, handle CDP cases. To handle the workload associated with CDP cases, Appeals is increasing the number of CDP trained employees to 482 in FY 2001. By the end of FY 2001, Appeals will have applied 180 FTEs to close 8,175 CDP cases. Projections for the first quarter of FY 2002 anticipate processing improvements resulting in 75 FTEs closing approximately 4,600 CDP cases.

|                   | 1999 | 2000 | 2001*  | 1 <sup>st</sup> Qtr 2002* |
|-------------------|------|------|--------|---------------------------|
| CDP inventory     | 4808 | 6602 | 13,296 | 13,105                    |
| Cases closed      | N/A  | N/A  | 8,175  | 4,600                     |
| FTE applied       | N/A  | N/A  | 180    | 75                        |
| Employees trained | 60   | 67   | 482    | 482                       |

\* Projected

**(10)(a)(2) How has the compliance cycle been affected by the due process provisions?**

The due process provisions have definitely slowed and lengthened the overall compliance cycle. In employment tax cases, for example, we estimate that in the best possible case it will take almost one year from issuance of the CDP notice for the Service to resume collection after a taxpayer has fully exhausted his due process rights. This estimate assumes that the case is moving through the process efficiently, with the taxpayer and the Service earnestly attempting to resolve the liability and without any delays attributable to a backlog. We estimate that, under the same scenario, other types of cases will take at least two-thirds of a year to process. A flowchart that shows the "best case scenario" timeline for a CDP case is attached.

These estimates are largely based on statutory waiting periods and the requirement that no collection action be taken prior to the exhaustion of the taxpayer's judicial due process rights. The CDP statute permits the taxpayer to contest the Appeals officer's determination by filing a petition in the Tax Court or U.S. District Court within 30 days of the determination. Accordingly, Appeals holds the case in its inventory until the taxpayer's statutory period under the Federal Rules of Civil Procedure for notifying the Service of a court petition has expired. In District Court actions, the total holding period is 180 days: 30 days to file a complaint, 120 days to notify the Government, and 30 days for the IRS to receive and process the notice that a court proceeding has been initiated. For Tax Court cases, the holding period lasts 90 days: 30 each to file a petition,

serve the petition on the Government, and for the IRS to receive and process the petition.

If the taxpayer does not seek court review of the Service's action, the case is then returned to the collecting office for appropriate action as determined by Appeals.

During this almost year long CDP period, the IRS takes no collection action. In the case of business trust fund taxpayers that continue to accrue additional liabilities even after requesting a CDP hearing, the process can be repeated with each new quarter of liability.

### **10(a)(3) What difficulties have arisen in implementing the due process provisions?**

As with any complex, new statute, implementing the Collection Due Process provision has been extremely challenging.

The technical challenges have included redesigning our computer systems to suspend the running of the collection statute while the CDP is pending. This capability went into effect in January 2001.

More noteworthy, however, has been the challenge of designing an efficient process that does not disproportionately expend resources on taxpayers and practitioners who abuse it to delay collection. Appeals settlement officers' inventories contain a significant percentage of cases advancing frivolous, patently meritless arguments. Moreover, the same taxpayers who advance these claims often request unreasonable or previously rejected payment arrangements during the CDP process. Nevertheless, before an appeals officer can issue a determination in one of these cases he must fully analyze each claim and payment offer.

Even after the determination letter is issued, these taxpayers often request additional Appeals hearings due to "changed circumstances", as permitted by the statute. The Service may resume collection at this point, nearly a year following issuance of the CDP notice. However, we must still expend valuable resources to address these new requests, instead of applying the resources to legitimate cases.

### **10(b) What progress has been made in increasing taxpayers' rights during collection actions?**

Significant progress has been made in implementing the letter and spirit of the CDP statute. To ensure the protection of taxpayer due process rights, we have provided tax law and procedural training to a significant number of Appeals and Collections officers. We should complete training for all Appeals settlement

officers, as well as those Appeals officers who handle CDP cases, by the end of May.

In addition, we have taken steps to ensure that taxpayers are fully informed of their rights. Finally, we have designed our systems to identify cases for which collection is prohibited. We are confident that we will continue to enhance the due process benefits afforded taxpayers under the Collection Due Process statute.

**10(c) What additional legal authority does the IRS need to fully collect taxes due and owing?**

We are concerned about the abuses described in response to Question 10(a)(3), and have had initial discussions with Treasury to identify possible legislative solutions. We anticipate recommending these solutions to the Joint Committee on Taxation and other appropriate Congressional committees in the near future.

Generally, we are exploring ways to reduce the length of time it takes to process employment tax cases, and minimize the use of abusive tactics and frivolous claims to delay collection.

**10(d) What is the staffing level for compliance activities for this year as compared to last year? What are the projected needs for staffing in this area?**

The table below shows the Fiscal Year (FY) 2000 -2001 staffing levels for collection activities in Service Center and Field Collection operations as well as the projected staffing levels for FY 2002. The FY 2002 levels reflect plans to hire 470 Revenue Officers in FY 2001. Since our last hiring initiative in FY 1995, we have experienced a steady decline in the number of field collection staff available to collect delinquent taxes and to secure delinquent tax returns. These additional Revenue Officers will stabilize the workforce and allow IRS to allocate resources to areas of concentrated workload.

In addition to increasing our Revenue Officer staffing levels, IRS is decreasing the amount of Revenue Officer time applied to filing season activities. In FY 2000, Compliance programs overall contributed 1,933 FTEs (Full Time Equivalents) to filing season programs that included Toll-Free Assistance, Walk-In Assistance and Outreach Efforts (e.g., Taxpayer Education, VITA and Tax Counseling for the Elderly). A key objective of the FY 2001/2002 STABLE (Staffing Tax Administration for Balance and Equity) budget initiative is to reduce this reliance on compliance and enforcement staff for taxpayer assistance. In FY 2001, 40 percent fewer FTE will be diverted to assistance programs. A second reduction of nearly 50 percent will occur in FY 2002 and, by FY 2003, we expect that detailees from Examination and Collection will be nearly eliminated.

For Revenue Officers specifically, the number of FTEs detailed to filing season activities will be reduced from 683 in FY 2000 to 376 in FY 2001 and to 189 in FY 2002. These Revenue Officer FTEs will be redirected to collection activities. The table below shows Revenue Officer FTEs available after considering the impact of details for filing season support.

| <b>FTE Category</b>           | <b>FY 2000</b> | <b>FY 2001</b> | <b>FY 2002<br/>Projected</b> |
|-------------------------------|----------------|----------------|------------------------------|
| Service Center Collection     | 2,501          | 2,634          | 2,662                        |
| Field Collection *            | 9,254          | 9,016          | 9,486                        |
| Revenue Officers **           | 6,195          | 6,089          | 6,559                        |
| Less: Filing Season Support   | 683            | 376            | 189                          |
| <b>Revenue Officers (Net)</b> | <b>5,512</b>   | <b>5,713</b>   | <b>6,370</b>                 |

\* Includes all GS-1169 series revenue officers, managers, clerical and paraprofessional employees in the field.

\*\* **Includes only GS-1169 series revenue officers and managers (frontline field, technical and insolvency)** Note: The Revenue officer category is a subset of Field Collection.

To address the growing number of Offer in Compromises cases, we are reviewing and reengineering our work processes and centralizing those cases most effectively worked in a service center environment. As part of that effort, we will be addressing the backlog in inventory and implementing improvements to efficiency.

Beginning in July 2001, all new OIC receipts will be sent to one of two service centers, depending on where the taxpayer resides. A staged implementation is planned between July and November, with actual casework beginning in August 2001. The table below shows the impact on staffing based on the projected increase in OIC cases and the centralization of OIC case processing.

|                | <b>Expected</b> | <b>Field</b>    | <b>Svc.<br/>Center</b> | <b>Field</b> | <b>Svc.<br/>Center</b> | <b>Total</b> |
|----------------|-----------------|-----------------|------------------------|--------------|------------------------|--------------|
|                | <b>Receipts</b> | <b>Closures</b> | <b>Closures</b>        | <b>FTEs</b>  | <b>FTEs</b>            | <b>FTEs</b>  |
| FY-2000 Actual | 109,296         | 84,391          | -                      | 1,230        | -                      | 1,230        |
| FY-2001 Proj.  | 129,230         | 87,000          | -                      | 1,267        | -                      | 1,267        |
| FY-2002 Est.   | 144,252         | 84,806          | 73,568                 | 1,236        | 938                    | 2,174        |
| FY-2003 Est.   | 161,020         | 84,806          | 91,920                 | 1,236        | 1,126                  | 2,362        |
| FY-2004 Est.   | 179,736         | 84,806          | 101,466                | 1,236        | 1,243                  | 2,479        |

**Collection Field staffing will remain constant at FY 2002 levels with the increase in receipts being handled in a more efficient and effective bulk process environment in the service centers.**

**10(e) Over the past several years, collection and compliance efforts have declined. The IRS has attributed the decline to a decrease in staffing**

**levels, diversion of resources to customer service, employee training, and increased time to needed to resolve cases. What does the IRS plan to do to increase its compliance activities?**

The IRS is taking several steps to increase resources applied to collection compliance activities. First, through the IRS Strategic Planning and Budgeting process, we are focusing our enforcement resources on those areas most in need of attention. In addition, we are undertaking several efforts to reengineer and realign work processes, with the goal of improving the effectiveness of our compliance activities. Finally, a new recruiting and hiring strategy will assure a more constant and stable workforce.

In the Strategic Planning and Budgeting process, new compliance strategies are being developed and current strategies are being updated to better focus collection compliance resources on those areas most in need of attention. For example:

- The National Nonfiler Strategy is a broad-reaching, multifunctional effort to bring nonfilers back into the system and to keep them there. It is supported by a continuing research effort aimed at identifying the most egregious taxpayer groups and determining causes of the noncompliance. By using information from State and private sector data sources, we expect to improve our case selection criteria and provide useful case file information to our Collection employees. In addition to direct enforcement efforts, we will develop education, outreach and alternative treatment programs to address noncompliance of those taxpayer groups likely to respond to such programs.
- A strategy to reduce Accounts Receivable is also being developed. As part of that strategy, we are piloting an effort to address trust fund pyramiding problem with in-business taxpayers through the use of the general civil injunction provision of the Internal Revenue Code. Through the IRS Office of Government Liaison and Disclosure and in partnership with the Federation of Tax Administrators (FTA), we are seeking 100% participation in the State Income Tax Levy Program (SITLP) with the 41 States that have an income tax. We also are working with the Financial Management Service (FMS) and other Federal agencies to expand and enhance the Federal Payment Levy Program (FPLP).

IRS has instituted a number of reengineering and redesign projects designed to improve the efficiency of its operations and to provide a higher level of consistency in its treatments.

- The Collection Reengineering project will address a number of mainline collection functions. For example, we will examine the assignment of trust fund cases from the Collection notice stream to Collection field enforcement to minimize delays between assessment and compliance contact. We will

seek to simplify our policy and procedures around referrals to Appeals, the pyramiding of trust fund liabilities, and case documentation and managerial review requirements. In the long term, we will be examining and rethinking all of our fundamental collection processes with the goal of improving efficiency and consistency in our treatment of taxpayers.

- To address the growing number of Offer in Compromise cases, we are reviewing and reengineering our work processes and centralizing those cases most effectively worked in service center environment. As part of that effort, we will be addressing the backlog in inventory and implementing improvements to efficiency. The table in answer 10(d) shows how IRS will handle the growing number of receipts and the effect on staffing levels.
- A project to enhance the Automated Collection System (ACS) will explore the use of the predictive dialer technology to commence outcall campaigns to targeted inventories. This improvement will allow the ACS outcall process to route answered calls back to employees dedicated to answering calls. It will also route no answer and busy calls to a research function designed to determine suspended or deferred status.
- The Compliance Risk project will identify and assign those cases that have the greatest impact on compliance. Through behavioral and application scoring of cases, high-risk cases will be identified and assigned earlier in the collection process.
- Our Vision Migration Strategy will centralize and consolidate the support services associated with case processing, workload delivery and technical support. This will streamline support services, resulting in efficiencies and the potential for reassigning enforcement personnel to front line activities.

To assure a constant and stable workforce, we have instituted a recruiting and hiring program that will result in hiring approximately 470 new Revenue Officers this fiscal year. This program will serve to continually replenish our workforce and will allow us to place employees in areas of concentrated workload.

**10(f) How has the IRS' ability to collect past due taxes improved or declined over the previous year?**

In comparison with FY 2000 results, IRS is experiencing both positive and negative trends in Collection activity during FY 2001. Enforcement actions are increasing in FY 2001, with positive trends in the number of liens filed and levies issued in both ACS and Field Collection. Through February 2001, both delinquent notice yield and Taxpayer Delinquent Account (TDA) dollars collected have increased. However, the number of TDA dispositions has decreased slightly in FY 2001. This is due to the need to redirect resources from TDA work

to handle the dramatic increase in the numbers of Offers in Compromise as well as Collection Due Process activities.

**10(g) Over the previous 12 months, has the time that elapses from the filing of the return to the first compliance contact been reduced? What is the current average amount of time that elapses between filing and the first compliance contact?**

Factors affecting identification and assignment of workload, such as the dollar amount, the taxpayer's response, the nature of the liability (IMF or BMF), IRS workload and available resources, do not allow us to compute average or standard timelines for compliance contact. However, the following information will give some perspective in the issue of timing:

- The time that elapses between the filing of a tax return and the time the first notice is mailed to the taxpayer has remained constant at six weeks over the years. This timing may expand to 8 weeks at the end of year cycles, as we gear up our processing systems for the next calendar year.
- If the taxpayer doesn't pay after the first notice, four additional notices are issued over the next 42 weeks prior to assignment to ACS.
- However, accounts meeting high-risk criteria are assigned to ACS approximately six weeks after the first notice. These cases account for approximately 20% of the inventory.
- In 2000, the average ACS assignment required 33 weeks prior to resolution. The FY 2001 plan projects a reduction to 26 weeks.

**10(h) It is our understanding that the IRS has instituted a policy that it will not enter into an installment agreement with a taxpayer unless the full amount due will be paid. If the taxpayer also is unable to qualify for an offer in compromise, e.g., the taxpayer has a home, but still wants to make payments to the IRS, what options does the IRS make available to resolve the liability?**

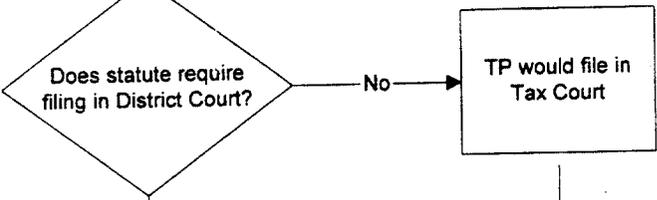
The determination that the IRS may not enter into an installment agreement with a taxpayer unless the full amount of tax due will be paid is based on a legal interpretation of the interplay of IRC sections 6159 and 7122, rather than any IRS policy. IRS Counsel advises that the Internal Revenue Code provides that only Section 7122, the offer in compromise provision, permits a taxpayer to resolve a tax liability for less than the full amount of the tax liability. Counsel further advises that Section 6159, the installment agreement provision, does not supersede Section 7122.

Last fall, a task force was charged with recommending ways to simplify and streamline the offers in compromise process. It is also examining alternatives for accepting offers in compromise where equity is present, but cannot be used to fund the offer, and the acceptance of offers in compromise where demonstrable hardship exists.

Nevertheless, we recognize that there is a gap in the payment alternatives available to certain taxpayers. We would welcome legislative guidance on how to close this gap.

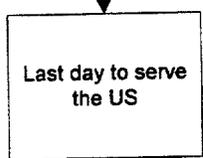
If we don't hear from the taxpayer we assume that they will file so procedures require that we wait the full amount of time allowable by statute.

Page 1



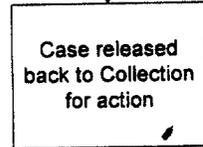
**120 days**

Statute provides 120 days for notice of filing to be served

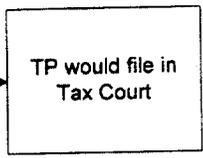


**30 days**

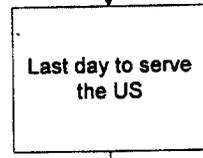
Procedures provide for 30 day delay to ensure service is complete



**30 days**

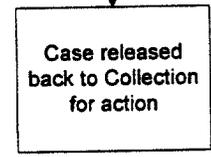


Statute provides 30 days for notice of filing to be served

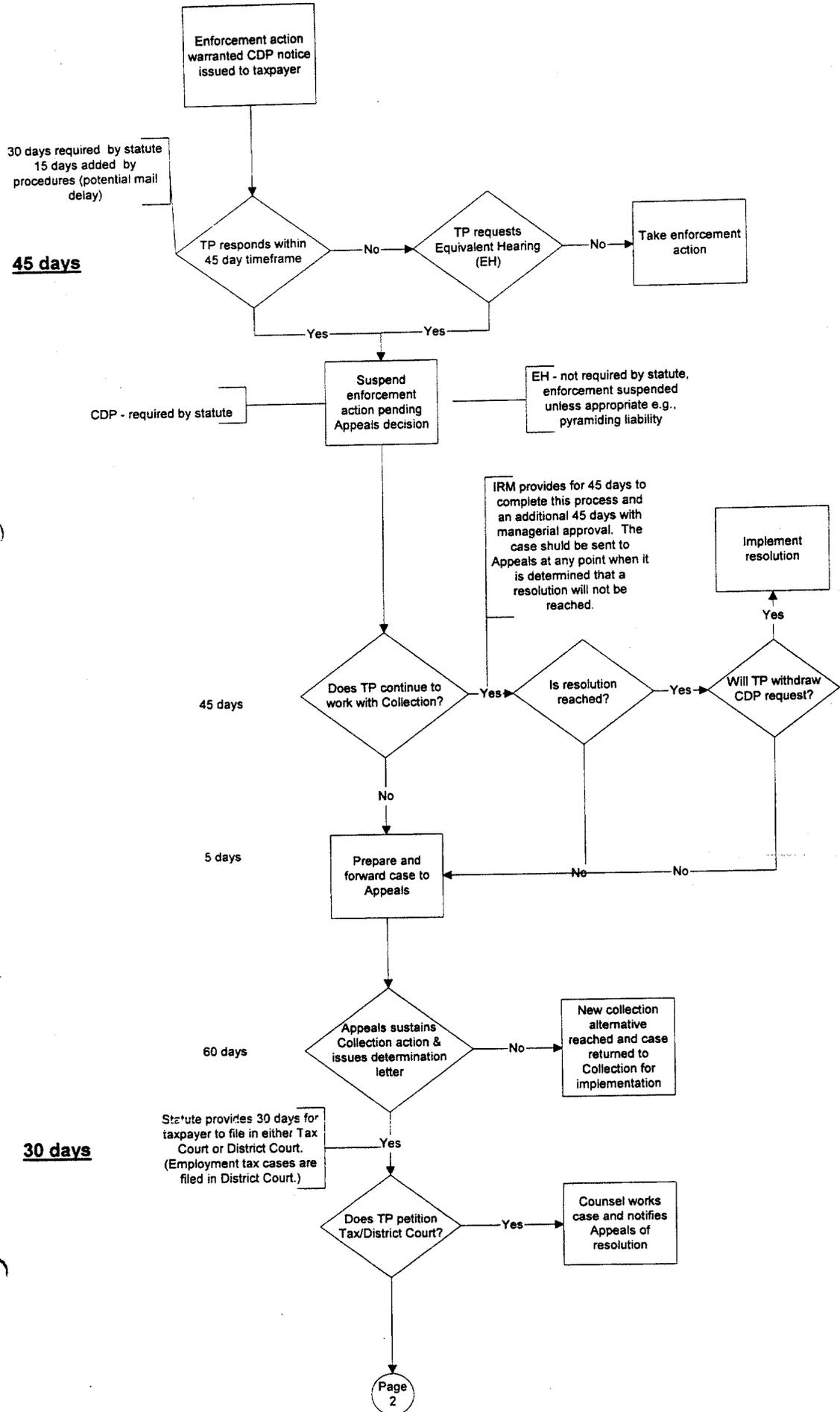


**30 days**

Procedures provide for 30 day delay to ensure service is complete



# Collection Due Process



## **11. Offers in Compromise**

### **11(a) What is the average time from submission to completion for an offer in compromise? Has this time been shortened as compared to last year?**

While we do not measure the “average” time, in fiscal year 2000 we completed processing 83% of the offers in compromise we received within one year of the offer’s submission. We resolved 38% of these cases within the first six-months and the remaining 45% by the end of the year. Through January 2001, we have resolved 32% of the offers in compromise submitted within the first six-months.

### **11(b) What has been done to shorten the time frames for processing offers in compromise?**

To shorten the time frames for processing offers in compromise, field resources have been realigned to increase the number of staff assigned. In FY 2000 we increased the revenue officer, paraprofessional, and clerical staff assigned from 762 to 1,230 FTEs and will further increase the staffing to 1267 by the end of FY 2001. We also reviewed our processes and procedures in an effort to shorten processing timeframes. As part of that effort, we will be addressing the backlog in inventory and providing additional recommendations to redesign the Offers in Compromise (OIC) process.

To address the increasing workload in the OIC program, we conducted a pilot project in two service centers to test the feasibility of processing offer in compromise cases of less than \$50,000 in a centralized environment. Based on the results of the test, we expect centralized bulk processing of OICs to produce gains in both staffing and time per case closure. Beginning in July 2001, all new OIC receipts will be sent to one of two service centers, depending on where the taxpayer resides. A staged implementation is planned between July and November, with actual casework beginning in August 2001. The table in answer 10(d) shows the impact of OIC centralization on staffing and inventory levels.

### **11(c) In 1999, the IRS added a fixed monthly payment option to the offer in compromise program.**

- (1) How many taxpayers have taken advantage of this program?**
- (2) Are these taxpayers making their payments timely?**

Our current automated Offer in Compromise system does not readily provide information about this kind of offer. However, we have plans to enhance our reports system to provide this type of information in the future.

**11 (d) The IRS Reform Act expanded the offer in compromise program to cases in which settlement would promote effective tax administration, including situations involving severe or unusual economic hardship. Have taxpayers been taking advantage of this expanded offer in compromise program?**

While the Service undertook a substantial effort to publicize the provisions of the new type of offer and embarked on a training program to educate Service personnel on the new provisions, receipts have not been as high as we expected. For FY 2000 and through February 2001, fewer than 1% of the total offers were filed under the effective tax administration (ETA) provision, including situations involving severe or unusual economic hardship. In FY 2000, only 580 such requests were received out of the total of 109,296 filed; through February 2001, only 380 have been received out of a total of 47,554 filed. All of the ETA offers claimed hardship issues for consideration. Approximately 88% of these offers have been accepted; the remaining 12% were either rejected or withdrawn.

**11(e) What, if any, are the administrative obstacles to prompt resolution of offers in compromise?**

The IRS Restructuring and Reform Act added additional requirements that lengthened the offer in compromise process. The law mandated a separate, independent administrative review before the Service could reject an offer in compromise or return the offer for failure to provide financial information. It also expanded the bases for compromise to include settlements that would promote effective tax administration. Hence, we must now also determine whether these special circumstances exist for each offer.

Also, in an effort to add flexibility to the program and to open the offer process to more taxpayers, we have relaxed our processibility requirements. We no longer automatically return offers that do not meet processibility standards unless the taxpayer is in bankruptcy or has failed to file tax returns. While this change has reduced taxpayer burden, it has increased IRS processing time and has caused our inventories to increase. We must now spend more time perfecting offers which we would have returned immediately to the taxpayer in the past.

As we discussed in response to Question 10 (h), Chief Counsel's interpretation of IRC 6159 no longer allows Service representatives to accept installment agreements that would not fully satisfy the entire tax liability. OIC and deferred payment offer have become the most feasible alternative of resolving these cases. The result is a substantially increased OIC inventory. This increased inventory also requires significantly more time per case to resolve than that required, for example, to complete an installment agreement disposition.

Evaluating and processing offers in compromise requires numerous processing steps that currently must be performed manually. Future automation could

alleviate some of the case building and financial verification aspects, saving costs and processing time.

## **12. Innocent Spouse**

**The IRS Reform Act made several changes to expand the availability of innocent spouse relief.**

### **12(a) What is the current backlog of innocent spouse claims?**

As of 3/6/01, we have 40,278 claims, affecting 21,198 taxpayers, where we have not notified the taxpayer of a determination. In FY 2000, we exceeded projections, processing a total of 42,546 innocent spouse claims, despite a 22% increase in receipts from the prior year. This meant that of the 111,243 claims (affecting 58,549 taxpayers) received since July 1998, we had not notified 21,136 taxpayers of our determination by the end of the fiscal year.

We believe with current increased staffing at the Centralized Site and with systems improvements we will be able to meet our projections for FY 2001. Our projected closures for FY 2001 is 57,659.

### **12(b) What is the average processing time for these claims?**

Average processing time varies from field area to field area and from field areas to the Centralized Site. The time calculated for processing takes into account required waiting periods to receive information and communicate with taxpayers, some of which is statutorily mandated, and normal processing times. For example, built into the process, before we can make a determination, is a 45-day waiting period to contact and wait for a response from the nonrequesting spouse. Also built into the process, after we have notified the taxpayer of a determination, is a 30-day opportunity for the taxpayer to request an administrative appeal and a 90-day period for the taxpayer to petition the Tax Court. Some of these timeframes may decrease now that a Technical Correction to section 6015 allows us to secure waivers, which will eliminate part of the processing time.

Claims receive an initial screening soon after receipt so we can notify taxpayers who file claims that do not qualify or do not meet basic requirements soon after filing. We decide those claims that pass this initial screening based on their merits. Claims that pass initial screening have longer lapse times than the other claims since they require an assessment of the facts, circumstances, and the complex technical aspects of section 6015.

We measured the lapse time from initial receipt of a claim to the date of a determination letter to the taxpayer and categorized the claims by type of disposition, comparing the full history of receipts to FY 2000 receipts. We found the following:

**Time from Claim Filing to Notification of Decision**

| <b>Average Lapse Time</b>    | <b>Full History</b> | <b>FY 2000 Receipts</b> |
|------------------------------|---------------------|-------------------------|
|                              | <b>Days</b>         | <b>Days</b>             |
| <i>Non-Qualifying Claims</i> | 142                 | 80                      |
| Basic Req. Not Met Claims    | 128                 | 81                      |
| Merit Claims                 | 318                 | 238                     |

Note: The above information is based on those claims where we have notified the taxpayer of a determination.

**12(c) What steps are being taken to decrease the backlog in requests for innocent spouse relief?**

We are taking the following steps:

- By May 2001, we will have increased the staffing at the Centralized Site by 50 positions during FY 2001, an increase of over 46% from the 107 employees in FY 2000. Thirty of the new positions are temporary in nature, created to deal specifically with the current backlog of inventory. We also upgraded the tax examiner position, increasing the number of examiners who make determinations on more complex claims.
- In January 2001, we developed and implemented an Integrated Case Processing (ICP) application in the Centralized Site. This computer workstation application embeds the algorithm for working an innocent spouse case that leads the examiner through the complex decision-making process, creating a workpaper trail to document the decision. We believe this application will allow us to increase productivity and provide more consistent application of the law. Additional phases of ICP will include account research and screening phases of the process.
- In January 2001 we implemented a new automated Master File account used for recording and maintaining information relating to separate spousal account transactions. It replaces the manual Automated Non-Master File system.
- Early in FY 2001 we detailed appeals officers to 120-day assignments in local field quality review sites to assist with backlogs in that stage of the process in the field.

We believe the above initiatives, will help us make significant progress toward achieving our goal of processing claims within prescribed timeframes. By December 31, 2001, we predict that our inventory level will be at a point where we can process claims received after that date within timeframes that closely approximate best case scenario timeframes.

**12(d) Does the IRS have sufficient staff to process these claims? If not, what are the staffing needs?**

We believe that with the staffing increases already accomplished and implementation of the recent computer-based decision-making tool, we have sufficient staff to process claims within acceptable lapse times.

**12(e) A taxpayer requesting relief under Code section 6015(b) has the burden of showing that he or she did not know or have reason to know of the understatement. When a taxpayer requests allocation of liability under Code section 6015(c), the IRS has the burden of demonstrating that the taxpayer did not have “actual knowledge” of any item giving rise to the understatement. The Taxpayer Advocate has identified these differing knowledge standards as a problem area. Has the IRS had difficulty applying the knowledge tests in administering the innocent spouse provisions? If so, please explain.**

We recognized this potentially confusing distinction in the knowledge standards early in the implementation process. Our national centralized innocent spouse case review identified that examiners were having difficulty correctly addressing these standards. Also, our Innocent Spouse Tracking System identified knowledge as the major reason for our denial of claims.

Identification of this problem was one reason we conducted two focus group sessions with experienced examiners during the development of the Proposed Regulations, issued this past January. Last May we completed a gap analysis of the knowledge criteria, identifying a need for additional training in this area. We developed and delivered training, “Innocent Spouse: Knowledge Criteria and Proposed Regulations,” early this March.

One of the factors considered under the equitable relief provisions pertaining to underpayments is the “reasonable belief that the tax would be paid.” We identified this as yet another knowledge standard where we needed additional guidance. We included some guidance in the training delivered early this March and we are reviewing the results of a test we conducted on underpayments to decide if we need additional guidance and training.

We are supporting the removal of the knowledge requirement under section 6015(c). We have received and decided few claims to date under that section (4,725 out of 42,324 decided “based on merit” or only 11% as of 3/6/01). In our

view, these low numbers support the elimination of a second standard, which has proven to be difficult and resource intensive to administer. We recognize that we would have to provide for a potential increase in claims if we eliminate these criteria.

Even with the potential removal of the knowledge requirement under section 6015(c), the remaining knowledge requirements that require difficult judgment decisions, will continue--the actual or constructive knowledge requirement of section 6015(b) and the "reasonable belief tax would be paid" requirement for underpayments under the equitable relief provision.

**12(f) What are the other legislative and administrative obstacles to prompt resolution of innocent spouse cases?**

None

## Chronology of Section 6015, Innocent Spouse

- January 1998      **Action plan** developed by Chief Office of Management Operations. Action items included revision of claim form, creation of new publication, an external communication strategy, and internal reminders.
- March 1998      **Cincinnati Service Center chosen** as centralized site for handling of Innocent Spouse Claims. Pipeline procedures developed including local tracking system.
- March 1998      Revised **Form 8857**, Request for Innocent Spouse Relief, published.
- April 1998      **New Publication 971, Innocent Spouse Relief**, published.
- April 1998      **Centralized Innocent Spouse Unit in Cincinnati Service Center** operational.
- 07/22/98**      **Passage of RRA 98, Section 3201, new Innocent Spouse Provisions.**
- July 1998      **IVT training** available to **all employees and RRA coordinators.**
- September 1998      **IRS Executives' Conference** - Innocent Spouse training.
- September 1998      **RRA 98 Training**, Phase I, included new Innocent Spouse provisions.
- November 1998      **Innocent Spouse Coordinators** designated for regions, service centers, districts, and Appeals.
- November 1998      Targeted **training for compliance employees** who handle Innocent Spouse cases.
- December 1998      **Notice 98-61 (1998-51 IRB 13), Interim Guidance for Equitable Relief from Joint and Several Liability**, was issued 12/07/99, to provide interim guidance to requesting spouses seeking equitable relief under Code section 6015(f). Public comment was solicited in developing final guidance.
- December 1998      **Taxpayer Advocate Directive 1998-1** issued on 12/7/98, directing waiver of accrued penalties on claims placed in suspense pending issuance of equitable relief procedures.

|               |  |
|---------------|--|
| December 1998 | Cincinnati Service Center - in <b>depth technical and procedural training</b> for 6015(f) reviewers, district coordinators, and tax auditors.  |
| December 1998 | Team from counsel, national office, management and front line worked cases to aid in IRM revision. <b>Flow chart developed, tested, and revised.</b>   |
| December 1998 | <p><b>Publications</b> were revised to include explanations of new law and required notifications:</p> <ul style="list-style-type: none"> <li>• <b>Form 8857, "Request for Innocent Spouse Relief," and instructions incorporating new provisions of law</b></li> <li>• <b>Publication 971, "Innocent Spouse Relief"</b></li> <li>• <b>Publication 1, "Your Rights as a Taxpayer"</b></li> </ul> |
| January 1999  | <p><b>Publications</b> were revised to include required notifications:</p> <ul style="list-style-type: none"> <li>• <b>Forms 1040</b></li> <li>• <b>Publication 1660, "Collection Appeal Rights"</b></li> <li>• <b>Publication 594, "The IRS Collection Process"</b></li> </ul>  |
| January 1999  | Temporary <b>National Centralized Review</b> of all <b>equitable relief cases</b> established to ensure consistency in application of law.   |
| February 1999 | <b>Week long training</b> for coordinators, reviewers, PRP/TAO, collection, appeals functions, and CSC.  |
| February 1999 | <b>Publication 556</b> , "Examination of Returns, Appeal Rights and Claims for Refund" was revised to include Innocent Spouse Reference.   |
| March 1999    | <b>Innocent Spouse Tracking System (ISTS)</b> went online.   |
| April 1999    | National Office <b>Training</b> of all District Innocent Spouse <b>Coordinators</b> completed.   |
| April 1999    | <b>Mass shipment</b> of cases from Cincinnati Service Center to districts because of backlog due to unexpected high volume of claims filed.  |
| May 1999      | <b>National Innocent Spouse Project Manager</b> selected.  |
| June 1999     | <b>National office quality review</b> of sample of cases.  |

- June 1999 **National meeting** of all District Innocent Spouse Coordinators to discuss barriers and direction of program.
- June 1999 **Appeals Centralized Post Review of equitable relief cases** established.
- July 1999 **Special Assurance Reviews** conducted in Cincinnati Service Center and 5 districts.
- July 1999 **Decision Tree** document created to assist in determining whether cases should be worked in Cincinnati Service Center or district.
- August 1999 **Decision Tree Training** conducted for all District Innocent Spouse Coordinators, their managers and branch chiefs.
- August 1999 **Interactive Video Training (IVT)** broadcast to employees focusing on difficult provisions of innocent spouse law.
- August 1999 **CPE** for all employees included Innocent Spouse.
- August 1999 **Executive Steering Committee convened** with program, function, national office and taxpayer advocate representatives.
- September 1999 **Temporary National Centralized Post Review of Innocent Spouse cases** established to review quality and conduct trend analysis. Superseded national review of equitable relief cases.
- October 1999 **Form 8857, Request for Innocent Spouse Relief**, and instructions, revised again to be more taxpayer-friendly, to eliminate the filing of claims not truly Innocent Spouse Claims and to refer taxpayers to Injured Spouse relief.
- October 1999 Debut of **Interactive Internet Application** - "Spousal Tax Relief Eligibility Explorer" - shared with 50,000 practitioners and on web site.
- November 1999 **3 Issue Specialists** selected (for Cincinnati Service Center, community property and overall).
- December 1999 Publication of **new/revised letters** to requesting and non-requesting spouses.
- January 2000 **Formal training course** on Innocent Spouse piloted.

|              |   |
|--------------|---|
| January 2000 | <b>Multi-functional team pilot</b> started in 4 districts to make innocent spouse determinations, drawing on expertise of various functions to reach determinations and handle account processing.      |
| January 2000 | <b>Issuance of Revenue Procedure 2000-15, Guidance for Equitable Relief from Joint and Several Liability (2000-5, IRB 447)</b> , on 01/18/2000, superceding interim guidance contained in Notice 98-61. |
| January 2000 | <b>Test of 1,000 CSC and 500 District cases</b> to enhance criteria used to assign cases to appropriate personnel in CSC or field.  |
| January 2000 | <b>IRS Executives' Continuing Professional Education - Innocent Spouse training.</b>  |
| March 2000   | <b>Formal Innocent Spouse training material</b> published.  |
| April 2000   | <b>Innocent Spouse Web Site</b> available for employees. Access to handbook, memoranda and job aides.   |
| May 2000     | <b>Innocent Spouse Tracking System training</b> held.   |
| May 2000     | <b>Quarterly National Meeting</b> of all regional and district Innocent Spouse <b>Coordinators</b> held.  |
| May 2000     | <b>First Quarterly Centralized Review Reports</b> including <b>Trend Analysis</b> generated and shared with field.  |
| May 2000     | <b>Gap Analysis of Knowledge and Allocation</b> completed. Identified need for training on knowledge criteria and allocation.   |
| June 2000    | Innocent Spouse Issue <b>Specialists started visits</b> to all districts to enhance exposure of Issue Specialist resource.  |
| July 2000    | <b>Innocent Spouse Internal Revenue Manual (IRM)</b> published.   |
| July 2000    | <b>Quarterly Centralized Review Reports</b> including <b>Trend Analysis</b> generated and shared with field.  |

August 2000      **Review of CSC denied cases** (concurrent by Centralized Review) to identify possible factors affecting denial rate variance with field.

September 2000      **Quarterly National Meeting** of CSC, regional and district Innocent Spouse **Coordinators** held.

October 2000      **National Appeals Review Program** of innocent spouse claims closed by Appeals in quarter ending 9/30/00.

October 2000      Started **test of cases**, working them both in CSC and in the field, to analyze and compare results.

November 2000      **Increased dedicated staffing at CSC** to work inventory.

November 2000      **Detailed appeals officers** to field quality review sites to **assist with backlog**.

November 2000      Quarterly **Centralized Review Reports** generated and shared with field.

December 2000      **Technical Correction** to innocent spouse code section 6015, PL 106 - 554, 114 Statute 2763. Allows for a waiver that will decrease processing time and clarifies refund provisions.

December 2000      Development of **training on domestic abuse issues** with input from outside expert. Topics include need for sensitivity in interview process, technical provisions of duress, relevance of domestic abuse in innocent spouse cases, and role of the nonrequesting spouse.

January 2001      **Proposed Regulations** published.

January 2001      Phase I of III of **Integrated Case Processing (ICP) System** for Innocent Spouse rolled out to CSC. This is a computer based work tool that was implemented to assist examiners in arriving at decisions more timely and with greater consistency of tax law applications.

January 2001      Implementation of a **new Master File account** used for recording and maintaining information relating to separate spousal account transactions. Will provide more accurate information, replacing the manual Non Master File account processing.

|                  |   |
|------------------|---|
| January 2001     | An <b>enhanced Innocent Spouse Tracking System</b> went on line.  |
| January 2001     | Provided field <b>direct access to Management Information Reports</b> and inventory listings  |
| January 2001     | <b>Quarterly National Meeting</b> of CSC and field <b>Innocent Spouse Coordinators</b> held.  |
| February 2001    | <b>Increased dedicated staffing at CSC</b> to work inventory.   |
| February 2001    | Using data from ISTS, identified the type of cases that may have impact on inconsistencies between CSC and field. Conducted <b>study of cases</b> to determine root causes.                                   |
| February 2001    | <b>IRS New Release</b> announcing process to flag cases and initiate special procedures when <b>victims of domestic abuse</b> fear retaliation when filing an innocent spouse claim.                          |
| February 2001    | Quarterly <b>Centralized Review Reports</b> including <b>Trend Analysis</b> generated and shared with field.  |
| March 2001       | Completed and aired video <b>training, Innocent Spouse Knowledge Criteria and Proposed Regulations. Student Guide</b> also published. Includes guidance on most troublesome areas – knowledge and allocation. |
| March 2001       | <b>Notice 1263, Notification to Your Spouse or Former Spouse About your Claim published.</b> Establishes a procedure for victims of domestic violence that fear retaliation.                                  |
| March 2001       | Publication 3512, <b>Innocent Spouse Relief Brochure</b> , revised to include website address and translated into Spanish.  |
| Short term goals | Revise and update formal training material and develop a computer-based format.   |
|                  | Train the new Taxpayer Revenue Representatives to make innocent spouse determinations during the non-tax season.  |
|                  | Roll out Integrated Case Processing application for innocent spouse to the field.   |
|                  | Revise claim Form 8857 and Publication 971 to simplify and clarify provisions.  |

**Completion and delivery of Domestic Abuse Training.**

**Revise and update multi-functional Internal Revenue Manual. Will add guidance for community property states and TEFRA procedures.**

Form 8857 &  
Statement Field  
2 Days

AS OF 03-06-2001  
CSC 383  
FIELD 484  
TOTAL 867

Initial Screening  
7 Days

AS OF 03-06-2001  
CSC 444  
FIELD 574  
TOTAL 1018

Order Files  
&  
Send Notification  
to Nonelecting  
Spouse  
45 days

AS OF 03-06-2001  
CSC 4778  
FIELD 325  
TOTAL 5103

Make  
Determination  
30 days

AS OF 03-06-2001  
CSC 12971  
FIELD 7344  
TOTAL 20315

Allow in Full?

Issue 30 Day  
Letter  
45 Days

Issue 90 Day  
Letter  
120 Days\*

Non-Masterfile/  
MFT 31  
Processing  
55 days

End

No

Yes

Yes

### BEST CASE SCENARIO

INITIAL NOTIFICATION TO SPOUSE 84 DAYS

TOTAL PROCESSING TIME 304 DAYS

#### Assumptions:

- Claims filed directly with CSC
- All information necessary to make determination provided at first inquiry

Additional time required if these assumptions not met.

There is an extra step in the process of 100% review of all field cases and a sample of CSC cases before a case goes to 30 letter status

As of 03-06-2001  
CSC 539  
Field 6867  
Total 7406

\*The recent Technical Corrections allows us to solicit a waiver, eliminating the 120 days on agreed cases

AS OF 03-06-2001  
CSC 3791  
FIELD 5253  
TOTAL 9044

AS OF 03-06-2001  
CSC 2854  
FIELD 2408  
TOTAL 5262

### **13. 2001 Filing Season**

**13(a) In August 1999, the IRS launched a service on its Web site that allows taxpayers to apply for installment payment arrangements online and mail in a computer-generated form.**

**13(a)(1) How many taxpayers have taken advantage of the on-line application?**

**13(a)(2) What percentage of installment agreement applications are made online.**

The "application" on the Internet for Installment Agreements does not directly allow a taxpayer to apply for an installment agreement on-line. Rather, it takes people through a process to calculate how much they can pay per month, to determine if that amount fits within Collection prescribed guidelines for granting an installment agreement. If this amount meets the guidelines, and the taxpayer believes they can continue the payments for the prescribed period of time, the system direct the taxpayer to download the Installment Agreement form, complete it with the information obtained from the on-line guidance, and mail it to the IRS. We do not track any information about how many people actually use the website to determine their eligibility or download the form, or any other information about taxpayers or installment agreements.

We count the number of "hits" for the Installment Agreement page; however, there are some anomalies in the data and we are not sure the page counts one hit every time some accesses the page. We count a hit for all the components that make up a page as it is sent from the server to the visitors browser, such that a complex page with graphics and files associated could register multiple "hits," and therefore multiple "visits" every time a visitor accesses a page. The Installment Agreement page counter tracks the number of visits to the "graphics" version and the "plain text" version of the website. The Interactive Installment Agreement page counts one "hit" every time a visitor accesses, so one could then interpret the "visits" reported as a unique visit. Since we established the counter in November 2000, the system has recorded 3426 visits on [http://www.irs.ustreas.gov/prod/ind\\_info/coll\\_stds/collect.html](http://www.irs.ustreas.gov/prod/ind_info/coll_stds/collect.html), the graphics page, and 1820 visits on [http://www.irs.ustreas.gov/plain/ind\\_info/coll\\_stds/collect.html](http://www.irs.ustreas.gov/plain/ind_info/coll_stds/collect.html), the plain text page. In total, the system has recorded 5246 visits to the Installment Agreement page. We capture this information and give it to the Collection content owner.

**13(b) Please highlight the challenges and significant accomplishments associated with the 2001-filing season.**

As always, our most significant challenge is meeting customer demand. We must hire and train 15,000 to 20,000 employees in our submission processing centers, our account management call and correspondence sites, and our walk-in

locations. We have 10 center locations, 27 call center sites and nearly 500 walk-in locations. This has become increasingly more difficult in the current economic climate. In 2001 we also reorganized into our new operating units which will serve us well but complicates the filing season. We are modernizing our processes, which also brings its own sets of challenges and affects our every day business. We however believe we have met these challenges and are experiencing an excellent filing season. Our most recent filing season statistics are shown in the table on the next page.

### **2001 CUMULATIVE FILING SEASON STATISTICS**

| <b>As of : (April 06, 2001)</b>             | <b>2000</b> | <b>2001</b>   | <b>% Change</b> |
|---|-------------|---------------|-----------------|
| <b>Total Return Receipts</b> (000's)        | 77,158      | 77,010        | <b>-0.19%</b>   |
| <b>Paper Returns Filed</b> (000's)          | 46,488      | 42,768        | <b>-8.00%</b>   |
| <b>Elec. Returns Filed:</b>                 |             |               |                 |
| Total (000's)                               | 30,670      | 34,242        | <b>11.65%</b>   |
| Practitioner                                | 22,336      | 25,207        | <b>12.85%</b>   |
| Telephone                                   | 4,522       | 3,856         | <b>-14.73%</b>  |
| Home Computer                               | 3,812       | 5,179         | <b>35.86%</b>   |
| <b>Refunds:</b>                             |             |               |                 |
| Total # (000's)                             | 61,868      | 61,705        | <b>-0.26%</b>   |
| Total \$ (Millions)                         | \$102,303   | \$107,356     | <b>4.94%</b>    |
| Average \$                                  | \$1,654     | \$1,740       | <b>5.20%</b>    |
| Direct Deposit # (000's)                    | 24,801      | 28,202        | <b>13.71%</b>   |
| <b>IRS Home Page Hits:</b> (4/08/01)        | 791,037,691 | 1,323,913,134 | <b>67.36%</b>   |
| <b>E-mail (ETLA) Receipts</b> <sup>1</sup>  | 182,636     | 130,625       | <b>-28.48%</b>  |
| <b>Telephone:</b>                           |             |               |                 |
| Total Assistor Calls Answered <sup>2</sup>  | 13,634,280  | 13,151,295    | <b>-3.54%</b>   |
| Assistor Level of Service <sup>2</sup>      | 62.10%      | 66.60%        | <b>7.25%</b>    |
| Total Automated Calls Answered <sup>3</sup> | 33,517,848  | 41,983,655    | <b>25.26%</b>   |
| <b>Telephone Quality Rates:</b>             |             |               |                 |
| Tax Law Quality <sup>4</sup>                | 71.03%      | 70.91%        | <b>-0.17%</b>   |
| Accounts Quality <sup>4</sup>               | 57.45%      | 69.89%        | <b>21.65%</b>   |
| Tax Law Correct Response Rate <sup>5</sup>  | n/a         | 81.50%        | <b>-</b>        |
| Accounts Correct Response Rate <sup>5</sup> | n/a         | 88.40%        | <b>-</b>        |
| <b>Total TeleTax Calls:</b>                 |             |               |                 |
| Total Calls Answered                        | 23,828,528  | 40,127,244    | <b>68.40%</b>   |
| Tax Law                                     | 3,886,497   | 3,279,240     | <b>-15.62%</b>  |
| Refund                                      | 19,942,031  | 36,848,004    | <b>84.78%</b>   |

| <b>Taxpayer Assistance Sites:<sup>6</sup></b> |           |           |                |
|---|-----------|-----------|----------------|
| IRS Assisted (04/07/01)                       | 4,981,774 | 4,287,789 | <b>-13.93%</b> |
| Volunteer Assisted (03/01)                    | 1,500,550 | 1,111,596 | <b>-25.92%</b> |
| Outreach and Other (03/01)                    | 277,004   | 169,449   | <b>-38.83%</b> |

<sup>1</sup>As of Apr. 07, 2001. Does not include deletes or test emails.

<sup>2</sup>As of Apr. 07, 2001. Includes only Product Lines 1040 (tax law), 8815 (accounts), & 4262 (refunds).

<sup>3</sup>As of Apr. 07, 2001. Includes TRIS call completions & TeleTax calls received from the call prompter.

<sup>4</sup>Through February of Fiscal Year

<sup>5</sup>Through March of Fiscal Year

<sup>6</sup> See accompanying highlights for explanation of this area

"n/a" means data not available. Also, details may not add to totals due to rounding.

, which is our goal.